Measuring Corporate Management and Leadership Capability

Andy Neely, Dina Gray, Mike Kennerley and Bernard Marr
Centre for Business Performance,
Cranfield School of Management
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A Report Commissioned by the
Council for Excellence in Management and Leadership
from the Centre for Business Performance at Cranfield School of Management

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Executive Summary:

The Council for Excellence in Management and Leadership commissioned the Centre for Business Performance at Cranfield School of Management to produce for them a report investigating the case for corporate reporting and disclosure in the field of organisational management and leadership. Clearly there are pros and cons for such reporting, especially if it is made compulsory through the forthcoming Company Law review, but on balance the authors are of the opinion that:

1. Greater corporate reporting and disclosure in the field of organisational management and leadership is not only desirable, but also inevitable.

2. Legislation may result in organisations reporting more in the field of organisational management and leadership sooner than they would otherwise, but in the longer term market forces will force them to report this information.

3. The steps that organisations are taking to adopt measurement frameworks that balance financial and non-financial issues mean that they are already building the infrastructure necessary to enable this reporting.

4. It is impractical to expect that a generic set of reporting standards applicable to all organisations can be developed for this area. It is widely believed that performance measures are context and strategy specific. Hence requiring organisations to report against a standard set of measures will simply result in additional bureaucratic burdens being placed on them.

5. An alternative, and much more pragmatic approach, however, is to accept that the role of measurement is to provide insight. What investors, and other external stakeholders, want is insight into the management and leadership talent pool that exists within organisations. As a result it should be possible to encourage and/or require organisations to release information in their annual reports which provides fact based insights into their management and leadership talent pool.

6. To provide a structure for such disclosure the authors recommend that a portfolio of critical questions about the management and leadership talent pool be developed and that organisations be encouraged and/or required to provide answers to these questions through fact based evidence of their own choosing.

7. Many organisations would benefit from the rigour provided by this approach. Far too often the performance measures that organisations have in place in the arena of organisational management and leadership are poorly developed and deployed.
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Background and Context:

The Council for Excellence in Management and Leadership commissioned the Centre for Business Performance at Cranfield School of Management to produce for them a report investigating the case for corporate reporting and disclosure in the field of organisational management and leadership. The report that follows is the result of that investigation.

In producing this report the Centre for Business Performance has deliberately drawn on a wide range and diverse set of literatures and ideas, ranging from the challenges facing managers and leaders through to corporate reporting and performance measurement frameworks. In doing so the authors have reached the conclusion that the increasing pressures on organisations, the growing interest in corporate reporting and disclosure and the increasing recognition that many of the drivers of the business value are intangible, all make it likely that organisations will be required by the investor community to release information on the status of both their current and potential management and leadership talent pool in the medium to long term. Legislation may speed up this process, but the reality is that investors increasingly appear to be interested not only in short term financial results, but also in the drivers of long term success and value. Many of them are now recognised to be intangible and all of them are steered by the corporation’s managers and leaders.

The authors also believe that it would be futile to develop a standardised reporting framework for management and leadership, which specified particular measures against which organisations should be required to report. The reality is that the measures used by different organisations are context and strategy specific. Hence a standardised set of measures would simply result in additional overhead and burden to organisations. This having been said, however, the authors take the position that measures exist to provide insight into an organisation’s performance. Hence rather than specifying what should be measured, it should be possible to specify what insights should be provided by organisations into their management and leadership talent pool. The view taken in this report is that the best way of achieving this in a meaningful way is to identify a standardised set of generic questions that organisations could be expected (and/or required) to address in their annual report. Answers to these questions would require fact based evidence and hence appropriate performance measures to be in place. It is suggested that these questions cover three specific issues: strategic, operational and balancing the short and long term.

The detail behind this structure, the rationale for it and the specific questions are presented at the end of this document. Before then a comprehensive review of three main areas are provided:

- The Changing Pressures on Organisations.

The State of the Art in Measurement Frameworks.

The first of these sections deals with the environment that managers and leaders find themselves in today and outlines some of the business pressures that result. The second explains recent developments in corporate reporting and highlights the growing pressure on organisations to release more non-financial information. The third reviews the measurement frameworks that exist today and explains how organisations are using these to pull together the data they need, often for internal reporting purposes.

While there are relatively few calls to date for organisations to release information on their management and leadership talent pool, the pressures on businesses, the changing nature of corporate reporting and the measurement frameworks that organisations are adopting, all suggest that it is only a matter of time before such demands arise. The pressures facing businesses mean that leaders and managers have to cope with and operate in an increasingly complex and inter-connected world. Investors, and other parties external to organisations, are increasingly likely to ask themselves can the current crop of managers and leaders (and perhaps more importantly the next generation of managers and leaders) cope with these challenges? As the revolution in corporate reporting and disclosure gathers momentum, more demands will be made on organisations for information to be released and and the demand for insights into the non-financial dimensions of performance will increase. We predict that this will include calls for information to be released on those who are responsible for delivering the non-financial dimensions of organisational performance, namely the managerial and leadership talent pool.

Finally, the fact that organisations are adopting alternative measurement frameworks, which balance financial and non-financial measures means that they are putting in place the infrastructure that will allow them to respond to these requests for more non-financial information. The natural tendency of investors and the markets appears to be to constantly seek more information, so the future is relatively easy to predict. Organisations, both by their own actions – adopting balanced measurement frameworks – and because of external pressures - the changing nature of corporate reporting - will be forced to release information on all aspects of their performance, including their management and leadership talent pool. It is these themes that this document seeks to explore in the sections that follow.

The Pressures on Today's Managers and Leaders:

The pressures on those who manage and lead businesses have grown inexorably over the last two decades. Competition is now global. The war for talent is real and becoming ever more fierce as organisations are becoming increasingly reliant on so called “knowledge workers”. Recent research, for example, suggests that in 1900, only 17 percent of all jobs required knowledge workers, whereas now over 60 percent do and clearly this change has implications for the appropriateness of traditional styles of management and leadership.

Of course, it is not just the nature of work and workers that is changing. Consumers are becoming more demanding and diverse in their expectations. Innovation never seems to keep pace with consumer demands. New products and services are taken for granted and, in many cases, superseded as soon as they are released. Add to this the cultural diversity and complexity introduced to many organisations by the increasing frequency of global mergers and alliances. Then pile on top the demands for cost down, quality up, faster, better, more choice. The list is endless and the game is clearly being played out on a global stage. One snap measure
of globalization, the share of economic production destined for sale in other countries, illustrates the point. In the U.S. economy, exports of goods and services were 4.9% of the gross domestic product (GDP) in 1965, but 10.8% of GDP in 2000. From a global perspective, exports rose from 12% of world GDP in 1965 to 22% of world GDP in 2000. In round numbers, international trade of goods and services has doubled in about four decades. The international financial markets have also expanded considerably, especially in the last decade. Total assets held by U.S. investors in other nations nearly tripled from $2.3 trillion in 1991 to $6.2 trillion in 2000. Conversely, total foreign-owned assets in the U.S. economy quadrupled from $2 trillion in 1991 to $8 trillion in 2000. Annual global flows of "foreign direct investment" - that is, investment that creates a lasting management interest, often defined as more than 10 percent of voting stock in a company - rose from $200 billion in 1990 to nearly $900 billion in 1999. In such a context it is clear that today's leaders and managers are operating in a business environment that is far more complex than that which their predecessors faced.

**Intangibles - The Value Gap:**

In addition to the pressures that globalisation places on today's leaders and managers, it is important to recognise that the whole nature of business is changing. Increasingly it is being argued that organisations create value - especially value recognised by investors - through intangible as well as tangible assets. Traditionally organisations have reported the value of their physical assets in their accounts and hence trained people to manage these physical assets. Recently, however, a growing number of commentators have pointed out that these physical assets in no way equate to the market capitalisation of firms (see table 1). Research conducted by Arthur Andersen consultants, Richard Boulton, Barry Libert and Steve Samek, for example, compared the market value with the book value of some 3,500 U.S. companies over a period of two decades. They found that in 1978 a company's book value was typically 95% of market value, whereas by 1998 its book value was typically 28% of market value. Why is this the case? Well part of the reason is a growing recognition of the importance of knowledge work. Take, for example, Oracle. The company's market capitalisation in August 2000 was $254,509 million, 39.4 times the value of its assets. How can this be? How can a business with physical assets of only $6,460 million be valued at $254,509 million by the market? The answer of course lies in the firm's intangible assets - brands, market position, capabilities, organisational knowledge, etc. The point is that a firm is far more than simply the sum of its physical assets. Indeed in today's information-oriented society, often the firm's intangible assets far outweigh its physical assets. So the question becomes how can executives and investors track whether a given firm is increasing or decreasing the value of its intangible assets. Hence the flurry of activity around intangible asset accounting and intellectual capital measurement. At the heart of this is not only a concern to be able to demonstrate to external parties the value of an organisation's intangible assets, but also to track whether particular managers and leaders are developing these intangible assets in ways, which will ensure the creation of value in the future.

Baruch Lev, one of the thought leaders in this field, argues that the usefulness of reported earnings, cash flows, and book (equity) values has been deteriorating over the past 20 years. And as a result there is increasing investor demand for relevant information and persistent regulator efforts to improve the quality and timeliness of financial information. The quality and timeliness themes have been picked up by the Centre for Tomorrow's Company in their call for "sooner, sharper, simpler" annual reports. Similarly Alan Greenspan, former Federal Reserve Board Chairman, complained in January 2000 that accounting wasn't tracking investments in knowledge assets and warned that this could cause problems.

| Table 1: The Hidden Value |
### Industry Knowledge

<table>
<thead>
<tr>
<th>Industry</th>
<th>Knowledge Capital ($ millions)</th>
<th>Knowledge Capital/Book Value</th>
<th>Market Value/Book Value</th>
<th>Market Value at 31/8/00 ($ millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aerospace and defence</td>
<td>23,447</td>
<td>3.58</td>
<td>1.8</td>
<td>11,407</td>
</tr>
<tr>
<td>Airlines</td>
<td>7,949</td>
<td>2.12</td>
<td>1.0</td>
<td>5,496</td>
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<tr>
<td>Biotech</td>
<td>4,393</td>
<td>5.18</td>
<td>16.3</td>
<td>13,940</td>
</tr>
<tr>
<td>Chemicals</td>
<td>9,948</td>
<td>3.08</td>
<td>2.2</td>
<td>7,746</td>
</tr>
<tr>
<td>Computer Hardware</td>
<td>49,857</td>
<td>6.69</td>
<td>17.5</td>
<td>202,719</td>
</tr>
<tr>
<td>Computer Software</td>
<td>38,908</td>
<td>5.68</td>
<td>15.2</td>
<td>48,465</td>
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<tr>
<td>Electrical</td>
<td>7,690</td>
<td>3.70</td>
<td>3.6</td>
<td>6,081</td>
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<tr>
<td>Electric Utilities</td>
<td>10,351</td>
<td>1.11</td>
<td>2.1</td>
<td>19,418</td>
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<tr>
<td>Food/Beverages</td>
<td>18,565</td>
<td>7.48</td>
<td>9.1</td>
<td>27,007</td>
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<tr>
<td>Forest Products</td>
<td>8,884</td>
<td>0.87</td>
<td>1.58</td>
<td>10,322</td>
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<tr>
<td>Home Products</td>
<td>19,296</td>
<td>8.10</td>
<td>6.6</td>
<td>29,257</td>
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<tr>
<td>Industrial</td>
<td>23,132</td>
<td>3.65</td>
<td>3.3</td>
<td>16,922</td>
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<tr>
<td>Media</td>
<td>16,759</td>
<td>0.94</td>
<td>2.7</td>
<td>82,396</td>
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<tr>
<td>Motor Vehicles</td>
<td>13,413</td>
<td>3.50</td>
<td>1.9</td>
<td>9,205</td>
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<tr>
<td>Newspapers</td>
<td>5,619</td>
<td>3.77</td>
<td>3.2</td>
<td>6,594</td>
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<tr>
<td>Oil</td>
<td>24,559</td>
<td>1.71</td>
<td>3.4</td>
<td>55,150</td>
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<tr>
<td>Pharmaceuticals</td>
<td>75,224</td>
<td>8.44</td>
<td>12.2</td>
<td>116,073</td>
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<tr>
<td>Retail</td>
<td>15,406</td>
<td>2.89</td>
<td>3.8</td>
<td>18,486</td>
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<td>Semiconductors</td>
<td>42,029</td>
<td>6.23</td>
<td>12.6</td>
<td>89,911</td>
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<tr>
<td>Speciality Retail</td>
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<td>2.62</td>
<td>8.0</td>
<td>17,154</td>
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<td>Telecom</td>
<td>81,221</td>
<td>3.26</td>
<td>3.5</td>
<td>118,288</td>
</tr>
<tr>
<td>Telecom Equipment</td>
<td>26,947</td>
<td>3.25</td>
<td>7.7</td>
<td>96,184</td>
</tr>
</tbody>
</table>

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**The Drivers of Value:**

Research carried out by Ernst and Young suggests that analysts recognise these trends and value companies based on their non-financial as well as financial performance, including the quality of an organisation’s management and leadership talent pool. One of the best known studies in this area, the Ernst and Young Measures That Matter study, concluded that institutional investors not only pay attention to non-financial factors, but also apply that knowledge when making investment decisions. From the 300 investment reports from brokerage firms and 275 portfolio managers that were surveyed, the report concluded that an average of 35% of the decisions to invest in or sell stock in a company relied on non-financial attributes.

Nearly 90% of the money management companies surveyed said that at least 20% of each investment decision relies on a company’s non-financial attributes, and more than one third said the figure was more like 40% to 60%. The results of the study imply that companies should articulate their non-financial accomplishments to their investors to better influence those who have control of their share price. In addition, the report implies that investors seek more than short term financial accomplishments in a company. Specifically, the eight “Measures That Matter” are identified as:

1. Execution of corporate strategy - how well does management: leverage its skills and experience, gain employee commitment, stay aligned with shareholder interest?

2. Quality of strategy - does management have a vision for the future, can it make tough decisions and quickly seize opportunities, how well does it allocate resources?
3. Ability to innovate - is the company a trend-setter or a follower, what’s in the R&D pipeline, how readily does the company adapt to changes in technology and markets? (Separate research undertaken by PricewaterhouseCoopers, as part of their ValueReporting programme, suggests that firms that generate 80% of their turnover from products introduced in the last 4 years double their shareholder value over the same period).

4. Ability to attract talented people - is the company able to hire and retain the very best people, does it reward them, is it training the talent it will need tomorrow?

5. Market share - is the company capturing the value of the current market, is it well positioned to expand that value in the future?

6. Quality of executive compensation - is executive pay tied to strategic goals, how well is it gauged to the creation of shareholder value?

7. Quality of major processes - does the organisation reduce risks and enhance return through the deft execution of its current operations, is the transition seamless to changing conditions?

8. Research leadership - how well does management understand the link between creating knowledge and using it?

The research also found that “when non-financial factors are taken into account, earnings forecasts are more accurate, thus reducing the risk to investors”. The researchers therefore go on to conclude that “if a firm’s non-financial data are strong, this could facilitate its ability to raise capital. The message is clear: non-financial factors can be used as leading indicators of future financial performance”.

When the study was replicated in the UK three years later, an almost identical list of the top ten non-financial measures that matter (albeit in a slightly different order of priority) was gathered. Indeed, the only significant difference was that Quality of Executive Compensation was replaced in the list by Global Capability - which could be as much to do with “Britishness”, or even a movement in attitudes during the intervening period, as about real differences of opinion amongst the investment community in Europe.

Yet another study of institutional investors and sell-side analysts globally - gathering survey data in the United States, United Kingdom, Netherlands, France, Germany, Italy, Switzerland, Sweden, Denmark, Australia, Japan, Hong Kong, Singapore, and Taiwan - identified nine financial and non-financial measures that they consider particularly important in making their investment decisions. These are:

- Earnings
- Cash flow
- Costs
- Capital expenditures
- R&D investment amounts
- Segment performance
Statements of strategic goals

New product development

Market share

Inevitably there are some industry-specific, as well as national, differences in the priorities that are given to individual measures by these professionals. Also, fund managers prioritise different measures from analysts. On the whole though, a large degree of agreement exists between institutional investors and equities analysts on both sides of the Atlantic and elsewhere as to what needs to be measured and reported from their perspective. Financial measures are critical for their short-term evaluations, while non-financial measures are key to longer-term assessment. The latter though are more like a kind of jigsaw puzzle or ‘future archaeology’, piecing together scraps of information to try to make a coherent picture of what is going on and to make predictions.

Globalisation and Competitive Advantage:
Add to these trends the ever increasing tendency for organisations to relocate manufacturing plants overseas to access alternative economies and lower cost bases and the importance of understanding how intangible assets drive the creation of value increases. As globalisation continues and more and more manufacturing is outsourced to developing and low labor cost economies, the work that remains is increasingly focusing on the high value activities - the creation of products and ideas, the delivery of services, the development of new businesses and markets. Stewart, for example, claims that “in 1999, knowledge was America’s most valuable export - the country took in $37 billion in licensing fees and royalties, versus $29 billion for aircraft”. Interestingly, now even some of this knowledge work is being outsourced to lower labour cost economies - e.g. software development in India. A recent survey by the Indian National Association of Software and Service Companies found that almost two out of five Fortune 500 companies currently outsource some of their software requirements to India, including American Express, Bank of America, GE and Target. The reason is simple: this approach saves time and money, but it does raise the question - what high value work will be left for the Western economies if this trend continues?

Other commentators reach similar conclusions. In a recent book, David Teece, says “the essence of the firm in the new economy is its ability to create, transfer, assemble, integrate, protect and exploit knowledge assets”. The reasoning behind this argument is that other sources of competitive advantage are increasingly becoming irrelevant or at the very least unsustainable. “Geographic advantages have been eroded by the spread of electronic commerce and reduced import and export tariffs. Regulatory advantages are being ironed out with the development of regional trading zones. Vertical integration is becoming less attractive because more and more companies are finding it cheaper to buy on the open market what they once made themselves. Unskilled work gives no competitive advantage, because anyone can do it. Technology that can be bought off the shelf, gives no competitive advantage, because anyone can buy it. Today competitive advantage comes from something proprietary -or at least hard to duplicate: a particular kind of knowledge, in the case of a company like Microsoft, or a unique combination of knowledge assets and physical assets, in the case of GE. The other sources of competitive advantage - assets to capital, materials, markets, equipment - have largely been competed away.

Clearly a fundamental challenge in helping investors understand the intrinsic value of a company is that it is inaccurate to describe a company solely in physical terms. Lowell L. Bryan,
a partner at McKinsey, for example, claims that U.S. companies need 20% less physical capital to produce a dollar’s worth of sales than they did twenty-five years ago. “Today you can open the annual report of a company, almost any company, turn to the financial statement at the back, and read about the physical assets, but you will find little or nothing about the assets that really drive the creation of value. Rajat Gupta, the head of McKinsey, has prophesied that within a decade at least one airline will exist that owns next to nothing in the way of physical assets, and relies instead on a virtual balance sheet of intangibles: a brand, a reservation system, landing rights, and a database.”

Together these trends have important implications for managers and leaders. It is not just that investors look at non-financial (intangible assets) to value businesses, but also managers have a desire to demonstrate to investors how they should value their businesses. Hence the rise of investor relations as a discipline. Increasingly executives are concerned about the gap between the actual share price and management’s perception of what the share price should be. The theory is that better reporting will tell the market and stakeholders what is actually going on. And this in turn should result in a better match between management’s perceptions of what the share price should be and what it actually is.

There is no sign that these pressures are going to disappear. In fact, in the aftermath of the Enron scandal, executives across the world are being forced to recognise that they have to be more open and honest about what they are doing and why they are doing it. No longer are shareholders willing to accept the party line. They are demanding more and more information about what the organisation is doing, why it is doing it and how it is creating value. In the pharmaceutical industry, for example, analysts are just as interested in the business’s new product pipeline as they are in its current financial results. For some, especially those who believe the rhetoric of city short-termism, this is surprising. But the reality is that the city cannot afford to be short-term. The largest pension funds own the majority of Britain’s businesses. The managers of these funds simply cannot afford to be driven solely by short-term interests. If they were and they all decided to shift their shares out of the countries’ largest businesses they would cause a market collapse overnight. Instead they have to take a long term view, but for them to be comfortable doing so, they have to be confident that the managers and leaders of the organisations they are investing in have the skills, knowledge and experience to ensure long term success.

Stakeholder Agenda:
This is not the end of the picture. In fact the pressures on business discussed above are the obvious ones. They are the ones that everyone recognises. Increasingly, however, there are other, more silent pressures. Pressures that are often not seen or acknowledged, but are nonetheless just as real. The role of business in society is changing and the days when business could exist solely to serve the needs to one stakeholder – the shareholder – are long gone. The days when business could exist to serve two stakeholders - the shareholder and the customer - are numbered if not already passed. Organisations today have to survive in a complex and multi-constituency world. They are asked by shareholders to reveal more and more information about their strategies, processes and capabilities. The media and pressure groups watch businesses like hawks watch prey. One false step and suddenly the business’ latest misdemeanor becomes headline news [see insert – The Emerging Stakeholder Agenda].

The Emerging Stakeholder Agenda
Now - and increasingly in the future - the best way for organisations to survive and prosper in the long term will be to think about the wants and needs of all of their important stakeholders and endeavour to deliver value to each of them. Simply focusing on a subset of seemingly more influential stakeholders - typically the
shareholders and customers – and ignoring the wants and needs of the rest is short-sighted and naïve in today’s information-rich society. One only has to observe some of the recent experiences of global organisations to understand the impact that other stakeholders – consumers, employees, suppliers, regulators, legislators, activists and communities – can have. Here is a more or less random dozen international examples to illustrate the point.

- Caterpillar – world renowned for its products, also goes down in the history books for enduring one of the longest running strikes ever. In a bitter seventeen-month dispute with the Union of Auto Workers, the company lost some three million working days.

- Marks and Spencer – a French court ruled that the UK-based retailer had broken labour law in attempting to close 18 stores in France, throwing its restructuring plans into disarray. The judge also fined the company FF25,000 for what she described as a “manifestly illegal troublemaking”.

- JCO Co. – workers at a Japanese uranium-reprocessing facility north of Tokyo set off a nuclear reaction in 1999 that resulted in two deaths and a further 439 being exposed to radiation fallout. An investigation revealed that the company was under pressure to cut costs and that an inadequate number of inspections had been conducted.

- Bridgestone/Firestone – carmaker Ford Motor Company has been waging a very public battle in the US with its Japanese-owned tyre supplier Bridgestone/Firestone. The spat has been about assigning responsibility – in other words, the blame – for tread separations on Ford’s Explorer model that have been the cause of over 150 road deaths. Firestone attributes the cause primarily to vehicle design, Ford to faulty tyre production. The product recall and other associated costs, not least legal ones, involved are astronomic and, at the time of writing, still growing. Firestone, meanwhile, has severed its 95-year supply relationship with Ford.

- Mars – despite the adverse publicity, the confectioner was considered fortunate in 1998 when it was found not to have breached the UK’s Food Safety Act after a mouse’s head and shoulders were discovered in a Topic bar. A woman had eaten most of the bar before discovering what she described as “a grey furry-looking object”. Mars said that the mouse parts had come from a consignment of hazelnuts from Turkey. In a separate incident, in 2001, the company was forced to destroy between two and three million Twix bars after beetles were found in its flour supply. Its quality control inspectors found black flecks in the popular snack’s biscuit base.

- Sara Lee – the US consumer goods group pleaded guilty to selling hot dogs and meats that were contaminated with bacteria, which led to 15 deaths in 1998. It was forced to recall 15 million pounds of meat. The company took a $76 million charge in 1999 for the massive meat recall.

- Snow Brand Milk Products – Japan’s largest dairy distributed contaminated milk in June 2000 and failed to notify the public for two days. During this time 14,500 people fell ill after drinking it.
• Sotheby’s and Christie’s – a grand jury in Manhattan indicted the chairmen of both Sotheby’s and Christie’s in May 2001 on criminal charges of conspiring to fix prices in the art auction market. Separately, the two companies jointly agreed to pay $512 million to former customers to settle a class action lawsuit that stemmed from the scandal. Sotheby’s has also been forced to pay a $45 million fine.

• Roche and BASF – Roche of Switzerland and BASF of Germany were fined a total of $725 million by the US Justice Department for indulging in antitrust cartel arrangements in their respective vitamins businesses. Executives also received fines and custodial sentences.

• Michelin – Europe’s largest tyre manufacturer was ordered to pay a €19.7 million (£12 million) fine by the European Commission for anticompetitive behaviour and abusing its dominant position in France throughout the 1990s.

• ExxonMobil – campaigners from several hundred non-governmental organisations (NGOs) launched “an international day of action” against the US oil company in July 2001. Protesters targeted offices and petrol stations around the world to highlight the firm’s stance on issues ranging from climate change to human rights.

• McDonald’s – the company may serve fast food, but it certainly takes it time in court. McDonald’s has the somewhat dubious honour of being the litigant in the UK’s longest ever libel trial, which lasted some two and a half years. With its annual income of over $30 billion, McDonald’s took on two unemployed British protestors – David Morris, an ex-postman and Helen Steel, an ex-gardener, who between them earned some $12,000. The protestors decided to defend themselves. They kept McDonald’s in court for a total of 313 days and had the chief executive over to give evidence. The legal fees alone are said to have cost McDonald’s approximately $10 million. While the impact of the adverse press and publicity is immeasurable. Over 250 press reports, a book and a sixty-minute documentary have all been produced, questioning why McDonald’s ever decided to take the protestors to court in the first place. In addition, the original leaflet that first sparked the libel action has been published on the McSpotlight internet site. To date this site has been accessed by over 12 million people.

All the evidence suggests that these pressures are increasing. Today’s executives have to manage relationships with multiple stakeholders. Clearly some stakeholders are more powerful than others, but in our view none of them can be ignored - not least, because one of the challenges is that the relative power of stakeholders varies over time. In food retailing, for example, the suppliers used to hold the power, but now with the growth of the supermarket chains, the power has in effect shifted to the retailers, such as Tesco and Sainsbury. Moreover, improvements in global communication technology (Internet, WAP, SMS) allow even small stakeholders to have a significant impact.

In essence then, executives today have to manage in the complex web of relationships, shown in figure 1. They have to cope with the varied and multiple demands of all of those who have a stake in the organisation. As, Anders Dahvig, CEO of IKEA, the Swedish furnishings company, says:

“The world has changed enormously in the past decade... All of us now act in ways we did not 10 years ago. Globalisation means stakeholders and responsibilities everywhere, which have to be managed. It’s quite a different level of complexity.”
In a similar vein, Chris Fay, former Chairman and Chief Executive of Shell UK is quoted in the Institute of Chartered Accountants 21st Century Annual Report as saying:

“The days when companies were judged solely in terms of economic performance and wealth creation have long disappeared. Today, companies have far wider responsibilities to the environment, to local communities and to the broader society. These are not optional extras. They are not the ‘icing on the cake’. I believe that Shell UK’s wider social responsibilities form a fundamental and integral part of the way in which we do our business. They are vital to our long-term economic performance.”

Figure 1: The Stakeholder Relationship Web

Given this growing complexity, an interesting question is raised. Namely, how do we know whether organisations have in place managers and leaders that can cope with it? For when they do not, the organisation’s fall from grace can be both spectacular and immediate (see insert - Coca-Cola’s Annus Horribilis).

Coca-Cola’s Annus Horribilis

On 5th December, 1999, the man who once said, “I know how all the levers work, and I could generate so much cash I could make everybody’s head spin,” fell on his sword and quit his job as chief executive of one of the world’s biggest and most admired companies. After just two years at the helm as Chairman and Chief Executive of Coca-Cola, Douglas Ivester, was forced to resign after a series of mishaps that had a disastrous impact on the company’s reputation and performance.

The reputedly data-driven and analytical former accountant and propounder of shareholder value, it seems, was using the wrong set of numbers to manage the business. Ivester’s twelve-month diary might read something like this:
<table>
<thead>
<tr>
<th>Month</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>February</td>
<td>Profit for last year down from $4.1bn to $3.5bn – Far East and Russian problems.</td>
</tr>
<tr>
<td></td>
<td>Fell out with UK retail customers over 10p per 2-litre bottle price increase.</td>
</tr>
<tr>
<td>March</td>
<td>Nominated as America’s second most admired company by Fortune.</td>
</tr>
<tr>
<td>May</td>
<td>Forced to radically restructure $1.85m Cadbury-Schweppes acquisition.</td>
</tr>
<tr>
<td></td>
<td>Warned by European Commission that company faces heavy fines for not seeking clearance for the acquisition from the competition watchdog.</td>
</tr>
<tr>
<td>June</td>
<td>Forced to recall and destroy 17 million cases of Coke in Belgium, France, Netherlands and Luxembourg following contamination problem, when over 200 consumers complained of illness. Company’s response seen as tardy and unsympathetic. Reputation as a reliable and responsible company shaken. Coca-Cola Enterprises incurs $103m additional cost.</td>
</tr>
<tr>
<td>July</td>
<td>Following complaints from competitors, European Commission officials raided offices in Germany, Denmark, Austria and the UK in a probe into whether the company offered retailers and wholesalers incentives to increase sales volumes, carry full range of brands, or stop selling competitor’s drinks through exclusivity deals. Coca-Cola Amatil under investigation by Australian Competition and Consumer Commission for alleged breaches of the country’s Trade Practices Act. These relate to the company providing Coke at discounted prices to certain retail outlets on condition that they did not stock rival beverages.</td>
</tr>
<tr>
<td>August</td>
<td>Accused by competition authorities in Italy of abusing dominant position, distorting competition rules through discounts and bonus system to wholesalers, and efforts to claim display space in supermarkets.</td>
</tr>
<tr>
<td>September</td>
<td>Being sued in Atlanta by four black workers for racial discrimination.</td>
</tr>
<tr>
<td></td>
<td>Market capitalisation has fallen $34 billion in past three months.</td>
</tr>
<tr>
<td>October</td>
<td>Pepsi suing in US over access to soda fountains, alleging unfair control of distribution.</td>
</tr>
<tr>
<td>November</td>
<td>Ordered to cease a promotional campaign by a Belgian court.</td>
</tr>
<tr>
<td></td>
<td>Price of syrup to bottlers raised by 7.7% (twice the rate of recent increases) - bottlers outraged.</td>
</tr>
</tbody>
</table>
French government blocks FF 4.7bn revised offer to purchase Orangina from Pernod Ricard.

December 1999  Fined $16m in Italy for “gravely” abusing dominant market position.

Meeting in Chicago with major shareholders, including Warren Buffett.

Resigned. Douglas Daft named as new CEO.

Ironically, on the day following the announcement, the company nominated in Financial Times as the world’s third most respected company (for second successive year).

January 2000  Chilean antitrust commission investigating company’s dominance of $800m-a-year soft drinks market.

Coca-Cola’s President for Northern Europe dismissed.

Profits down 31% last year.

Announced plans to cut 21% of workforce worldwide - 6000 jobs lost.

February 2000  Dropped from Fortune’s list of the Top 10 Most Admired Companies.

**Corporate Social Responsibility:**

One way of looking at these issues is to think of them in terms of business risk and particularly reputational risk. In the area of health and safety (as well as environment, sustainable development and business integrity) the notion of risk and its potential impact has been recognised for many years. The Global Reporting Initiative, for example, an international coalition of companies, accountants, NGOs and trade unions is quietly changing the way companies report on sustainability issues. “The Global Reporting Initiative (GRI) has been pioneering the development of corporate reporting guidelines that go to the heart of the sustainability debate. The GRI is built around a simple, but effective, notion. By providing a broadly agreed mechanism to measure environmental and social performance, the GRI aims to assist investors, governments, companies and the wider public to understand more clearly the progress being made towards sustainability, and to improve related analysis and decision-making”.

In addition the same issues are also being addressed through the agenda of diversity and equal opportunity – see for example the recent Kingsmill Review. The flip side of this risk agenda is, of course, the Corporate Social Responsibility agenda, which is also gaining momentum, with many high profile brokers and investment houses launching socially responsible and ethical investment funds. 10th July 2001, for example, saw the launch of the FTSE index for socially responsible investment, called FTSE4Good. FTSE4Good is a series of benchmark and tradable indices designed to facilitate investment in companies with good records of corporate social responsibility. The aim is to provide an objective standard for socially responsible investment based on criteria regarding: (i) environmental sustainability; (ii)
social issues and stakeholder relations and (iii) human rights. Full selection criteria are available on the http://www.ftse4good.com/ website.

FTSE claim that the index is unique in providing the opportunity to identify and trade in socially responsible companies. However, there have been criticisms of the index. Primarily these appear to be based on the selection of companies - i.e. that selection is based on whether a company effectively understands and reports its social and environmental impact rather than whether that impact is positive. Furthermore, the Centre for Tomorrow's Company argues that FTSE4good is good as far as it goes, but the only way to make a real difference in this area is to promote ethical investment amongst mainstream pension funds and unit trusts.

Accompanying these growing and complementary agenda of risk and corporate social responsibility, is also a growing cynicism and scepticism amongst the public at large. Mark Wade, who is Head of the Sustainable Development Group at Shell International Ltd, talks about this in terms of a shift from a "trust me" to a "show me", to an "involve me" attitude. A decade ago it was perfectly acceptable for those with social status – politicians, doctors, lawyers, academics – to say to those around them "trust me, I know what I am doing". But in the intervening years we have witnessed a catalogue of disasters. Politicians have demonstrated on numerous occasions that their whiter-than-white image is merely a thin veneer – Bill Clinton and Monica Lewinski, for example. Doctors have fundamentally abused the trust patients have placed in them – Professor Van Hewsen and the Alder Hey hospital scandal, for instance, which involved the systematic "harvesting" of organs from children without parental consent. Increasingly, society is saying to those in power and with authority – we won't trust you. We want you to show us. We want evidence that what you say is true.

So how do we provide evidence? The answer is simple – through measurement data. Hence the rapid emergence and dissemination of league tables, performance standards, accreditation kitemarks, and so on. In the university sector, management schools across the globe are regularly ranked in terms of teaching and research performance by the Financial Times, as well as the Higher Education Funding Council and the Government sponsored Research Councils. In health care, performance league tables, summarising operation success rates and recovery times, are widely available. In education, school league tables, identifying the percentage of pupils graduating and gaining other levels of achievement, are produced so that parents and policy makers can be better informed about school performance.

And it is not just in the public sector that organisations have to demonstrate how well they are performing across a broad spectrum of measures. In the private sector, organisations have invested millions of dollars developing sophisticated internal and external reporting processes. The employee-customer-profit chain, for example, is based on the assertion that happy employees lead to happy customers and that this results in excellent financial results. Organisations, such as Sears, have tested this model and find evidence that it holds true for them. The more evidence that supports this argument the more that people will be convinced of the case for predictive performance measures - ones that allow future business results to be understood and as they seek these, they are going to turn to the non-financial dimensions of performance.

These trends show no signs of waning and the calls for more disclosure grow ever louder. It is for these reasons that, in our view, investors will continue to demand more information. As time passes they will not settle for information just on intangible assets. They will increasingly demand information on a whole host of performance dimensions, especially those that are shown to be leading indicators of future financial performance.
Management & Leadership:
There is growing evidence that many believe that one such dimension is management and leadership. One study, reported in the Financial Times, explored what traits characterised companies that were successful in terms of total shareholder returns over extended periods of time. The study identified that amongst the most important factors were strong, innovative managements with a track record of international success. The outright winner - Nokia, the Finnish mobile phone manufacturer - exemplifies these traits. The business, which has generated a total shareholder return of 1,660% over five years is reputed to have extremely strong management, with a clear strategic vision. At a more general level, the Financial Times study reported that the most outstanding companies in the table tended to share many of the following characteristics:

- “A strong management, clear of its strategy, able to communicate it easily to staff, customers and investors, and then execute rigorously.

- An ability to innovate, be it in technology, product design or customer relations. Skandia, once a dull composite insurer, has pioneered the idea of wholesaling products rather than acting as a retailer or fund manager.

- Successful international expansion. Aventis, ranked eighth in the table, with a five-year TSR of 512 per cent, is a pharmaceuticals company formed from the merger of France’s Rhone Poulenc and Germany’s Hoechst. Drug company mergers are notoriously disappointing but this one has produced cost synergies faster than expected and stronger growth from its main products due to greater marketing clout. It has performed particularly well in the US, the world’s most lucrative drugs market, where neither of its predecessor companies was big enough to make a dent.

Further evidence for the importance of management vision is further highlighted by the annual Financial Times/PwC most respected companies survey. The reasons cited for respecting companies vary greatly suggesting that there is no “template or formula” for business success. However vision emerged as the most common attribute displayed by the most respected business leaders. It is this vision that enables managers to deliver the context specific drivers of company success.

As this evidence mounts it is clear that analysts’ perceptions of quality of management and leadership must influence share price valuations. The problem today, however, is that far too often analysts are simply relying on their perceptions. And these in turn are based on anecdote and the reputation of the business’s leaders. Looking forward, as the move from a “trust me” to a “show me” to an “involve me” society gathers pace then we believe that analysts and investors will increasingly look for hard evidence about the quality of an organisation’s managers and leaders. Furthermore they will not only want information on the quality of today’s managers and leaders, but also about the next generation. The result will be that analysts and investors will look for insight into the organisation’s managerial and leadership talent pool, which in turn will result in them asking organisations to release information on this.
The Disclosure Caveat:
The one caveat that needs to be raised, however, is the pressure that disclosure places on organisations to deliver. There is concern in some quarters that the resultant pressure could result in cheating in corporate reporting. This concern was raised by former Securities and Exchange Commission Chairman Arthur Levitt. Levitt is reported to have said “conflicts of interest cast doubt on the motivation of a broker, analyst, or corporate manager, where hidden costs hurt an investment’s bottom line and where accounting tricks dress up a company’s financial results”. Similarly, research by CEST - the Centre for Exploitation of Science and Technology - studying city analysts and finance directors from FTSE 100 companies found that both groups are dissatisfied with existing formal reporting mechanisms and castigate balance sheets as irrelevant. Both analysts and FDs have a marked antipathy to standardised accounting and reporting and none want to see a statutory formal reporting system for intangibles. Corporate players are convinced that intangibles are absolutely central to the success of their business. However there is also widespread corporate concern that reporting value creation from intangibles would create ‘a rod for our own backs’, leading to unrealistic expectations of year-on-year improvement of any quality measured and reported. The report believes that pressure for change must come from business rather than the City. It recommends that corporates create, test and use measurement and reporting systems for intangibles, deploying them internally for several years before going public with their results. In the meantime there should be a focus on ‘thought leaders’ in the City who will influence fellow analysts when new types of reporting are released.

Of course there is a counter-argument to this stance. Namely that without legislation companies will not be as responsive when it comes to disclosure as they should. A survey of the top 200 UK Quoted companies showed that 97% do not disclose any information on their social and environmental performance. This despite the Government’s challenge, issued in a speech by Tony Blair in October 2000, that “all of the top 350 companies to be publishing annual environmental reports by the end of 2001”. Only 16 companies said that they would report on these issues for the first time in 2001.

The Changing Nature of Corporate Reporting:
It is a reality that globalisation, intangibles, stakeholder relations, corporate social responsibility and management and leadership are resulting in greater pressure on organisations and indeed this pressure has already resulted in significant change. Through their ValueReporting research, PricewaterhouseCoopers have observed changes in approaches and attitudes to corporate reporting over a number of years. Their research shows that the majority of CEOs believe that their stock prices are either significantly over or under valued depending on which side of the new/old economy divide they sit. A survey conducted in 1998, for example, found that 40% of CFOs in US and UK believed that their company’s stock was undervalued. Furthermore the PwC research found that those involved in all sides of the capital markets are questioning what information they need to be better able to understand current organisational performance and predict future performance.

To address this issue PwC have developed a framework (ValueReporting) that provides guidance on how to incorporate information on the business’s value drivers into a company’s internal reporting systems, so that management can become familiar with how the value drivers translate into sustainable cash flows. This framework includes:

- Market Overview (competitive position, regulatory environment, macro-economic environment).
- Value Strategy (goals, objectives, governance, organisation).


- ValuePlatform (i.e. drivers of value - innovation, brands, customers, supply chain, people, reputation - social, environmental, ethical).

PwC argue that management make little attempt to communicate this information and their research found that although investors and analysts both demand more information on the cost structure of businesses, the quality of cost information is generally poor. In addition they highlight the benefit of XML and XBRL tags that can be used to automatically identify data required by investors or analysts, facilitating increased reporting speed and ability to manipulate data. The research predicts that in the future data will be made available in real-time and data on “soft issues”, that will enable value judgements to be made, will be released.

In terms of best practice, PwC have also identified exemplar companies against each of the elements in their Value Reporting framework. These exemplar companies include:

- Market overview - requiring companies to give a clear and unbiased overview of the markets in which they operate, covering current and anticipated economic regulatory and competitive conditions.

  1. Competitive environment (Telstra; Volvo).
  2. Regulatory environment (United Utilities).
  3. Macro-economic environment (Alcan; Munich Re Group; Noranda inc.; United Utilities; Volvo)

- Value Strategy - clearly setting out the company’s strategy. Stating what they are striving to achieve, what steps they are taking to deliver the strategic goals and how these steps will create value for the shareholders.

  1. Goals & Objectives (Bank of Montreal; Barclays; Dow Chemical; Mackenzie Financial Corporation; Novo Nordisk; Shell).
  2. Governance (Dow Chemical; Mackenzie Financial Corporation; Novo Nordisk; Shell).
  3. Organisation (Novo Nordisk)

- Managing for Value - clearly communicating the results of actions taken to achieve the strategic objectives.

  1. Financial performance (Alcan; Bank of Montreal; BP Amoco; Diageo; ING Group; Manitowoc Co.; Rio Tinto; Siemens).
  2. Financial position (ING Group; JP Morgan; Siemens).
4. Business segment analysis (Alcan; Deutsche Bank; JP Morgan; ING Group; Siemens)

- ValuePlatform - clearly communicating all of the non-financial elements that need to be actively managed to optimise shareholder value.

1. Innovation (Axcan Pharma; Coloplast; Maintowoc).

2. Brands (Carl Bro Group; SCA; Shell).

3. Customers (Canada Trust; Coloplast; The Cooperative Bank; i2 Technologies; Post Denmark; The SAS Group; Suncorp Metaway; Westpac).

4. Supply Chain (BT; Coloplast; The Cooperative Bank; Post Denmark; The SAS Group).

5. People (BP Amoco; BT; Coloplast; The Cooperative Bank; Post Denmark; Shell).

6. Reputation (BP Amoco; BT; Rio Tinto; The SAS Group; SCA; Shell; Xerox Corporation)

In addition to the PwC work, three organisations concerned with performance measurement have recently published reports discussing deficiencies in corporate annual reports and the way in which organisations communicate with their investors. Reports by the Institute of Chartered Accountants in England and Wales (ICAEW)\(^{xxxiv}\), the Centre for Tomorrow’s Company (CTC)\(^{xxxv}\) and the Foundation for Performance Measurement (FPM)\(^{xxxvi}\) each conclude that the current format of company annual reports is an inappropriate means of communication. They agree that, currently, company reports do not provide sufficient insight into future performance, only providing bland statements about activities, with many reports making assertions about current and particularly future performance, without data to back them up.

All three of these organisations suggest that new approaches should be taken to corporate reporting that more closely consider requirements of all stakeholders and are customised to reflect them, provide greater insight into all dimensions of performance, are more frequent and use a wider range of communication technologies. They should also reflect the organisation’s ambitions and strategic direction, whilst reflecting non-financial performance measures that are used internally to manage operations. They suggest company reports of the future will be more up to date, informative and engage stakeholders in dialogue. The ICAEW and CTC reports include details of Prototype plc. Based on a fictitious company, Prototype plc “is an example of a core report to which other key reports can be appended”. Chris Fay, former Chairman of Shell UK, stresses that this more inclusive type of reporting should not merely be pigeon-holed as a public relations or communications strategy, but provide “tangible progress toward external verification of financial, environmental and social performance”.

It is not just commentators and academics that are calling for these changes. Organisations as diverse as BT, Co-operative Bank, Shell and Skandia have all made significant strides in changing corporate reporting standards. BT, for example, produced its first social report in 1999. Not all of it is favourable to the company. A survey of employee satisfaction shows, for example, that only 39% were happy with leadership at BT, a figure that compares unfavourably against a benchmark of comparable companies. The report is a serious if tentative attempt to provide quantitative, independently compiled data on BT’s relationships with shareholders, customers, employees and the community. (A methodology is still being tested to monitor relations with suppliers). Independent verification is provided by the Ashridge Centre for
Business and Society, which provides a broadly favourable verdict, while suggesting areas for improvement.

Sir Iain Vallance, the then chairman of BT, says in the preface that the prime purpose of the business is to create value for shareholders while looking after all other important constituencies. A statement of BT’s values then reveals the company puts its customers first. This apparent contradiction encapsulates a point Sir Iain himself makes: “there is no escape, even if you believe in the primacy of shareholders, from balancing the interests of varying constituencies.”

The Co-operative Bank has taken on board the message from the Tomorrow’s Company Inquiry in the Role of Business in Tomorrow’s Society and now report on an inclusive basis, featuring specific material for each of their stakeholder groups. Their ‘Partnership Report’, which was first produced in 1998, reports how well the business has performed against the expectations of all of its stakeholders - shareholders, customers, staff and their families, suppliers, local communities, national and international society, past and future generations of ‘co-operators’. More formalised approaches to stakeholder accountability and reporting are being developed and documented. The Institute for Social and Ethical Accountability, an international membership organisation based in the UK, for example, has been involved in the production of The Copenhagen Charter - A Guide to Stakeholder Reporting - and the development of the AA1000 stakeholder reporting framework.

Shell focuses on explaining their business principles and strategy to their stakeholders, through their Profits and Principles publications. The 2001 report, that has just been released, talks about Shell’s strategy and how the business is managed according to three clear and consistent values:

1. Economics - generating robust profits.
2. Environmental - protecting the environment.
3. Social - respecting and safeguarding people.

All information provided in the Shell Report is verified by external auditors - KPMG and PwC. Shell seeks to use the report to actively encourage dialogue with its stakeholders. The business has established a “Tell Shell” initiative: “Tell us what you think - about Shell, our performance, our reports or the issues we face. Join the global debate - we value your views. You can do this via email or Internet at www.shell.com/tellshell or tell-shell@si.shell.com”. Mark Wade, Head of Shell’s Sustainable Development Group, says “people feel good when they see their personal value systems aligned with corporate performance... it is exhilarating for them to know that it’s not just how much money you make, but how you make it”. John Browne, Director of Reputation Assurance at PriceWaterhouseCoopers, echoes and reinforces the point when he says “there is a demographic hole in the UK for new graduates... the number of good graduates from good universities is declining sharply, and they are also increasingly sophisticated. If your reputation is dodgy, you are going to find it difficult to attract bright young people.”

Skandia are widely acknowledged as the pioneers of intangible asset reporting. They produced their first supplement to their annual report in 1995 and are widely considered as the first company to have implemented a systematic effort to assess and report the organisation’s intangible assets. In order to assess its “true” market value Skandia suggests that market value should be split into financial capital and intellectual capital. The latter is considered to be equivalent to the firm’s intangible assets and has been further sub-divided into human capital -
i.e. the know-how of the workforce – and structural capital - other intangible assets embedded in the organisation. Structural capital is then further sub-divided into customer capital - the value of customer relations and brand, and organisational capital. The latter can be further broken down into process capital, related to the procedures and routines of the company’s internal processes, and innovation capital, that represents the enablers to innovate products and processes. Effectively then the Skandia approach splits intellectual capital into the following four categories: human capital, customer capital, process capital and innovation capital (see figure 2).

**Figure 2: Skandia’s Classification of Intellectual Capital**

![Diagram of Skandia's Classification of Intellectual Capital]

### Frameworks and Methodologies

On the basis of the above classification, Skandia has developed an Intellectual Capital assessment tool called the Skandia Navigator, which is but one of the recently released performance measurement frameworks. The Skandia Navigator is very similar to Kaplan and Norton’s Balanced Scorecard, but identifies the following five foci of measurement: the financial focus, the renewal and development focus - innovation capital, the human focus - human capital, the process focus - process capital and customer focus - customer capital (see figure 3).
The question at the heart of much of the debate in the area of corporate performance reporting is the question - what drives value? As has already been discussed, it is increasingly recognised that value does not lie solely in the tangible and physical assets of organisations. Indeed there is a significant amount of evidence that suggests that for many businesses their value lies in intangible assets - at least in the stock market's eyes. But these intangible assets are not reflected on the organisation's balance sheet, other than in goodwill, so now the search is on for better and more sophisticated ways of measuring the value of intangible assets.

In addition to these external pressures there is growing recognition that the measurement systems used to manage businesses themselves need to be enhanced. Influential books and papers, such as "Relevance Lost" and "Managing Our Way to Economic Decline", have lead to a groundswell of opinion and a growing recognition that the measures used by many businesses to track their performance are woefully inadequate, not least because they:

- Encourage short-termism, for example the delay of capital investment.
- Lack strategic focus and fail to provide data on quality, responsiveness and flexibility.
- Encourage local optimisation, for example “manufacturing” inventory to keep people and machines busy.
- Encourage managers to minimise the variances from standard rather than seek to improve continually.
- Fail to provide information on what customers want and how competitors are performing.
The same measures are criticised for being historically focused\textsuperscript{viii}. Sales turnover, for example, simply reports what happened last week, last month or last year. Whereas most managers want predictive measures that indicate what will happen next week, next month, or next year.

Numerous managers suffer from data overload. Most firms have information systems that generate at least some redundant performance reports. Comments such as “we measure everything that walks and moves, but nothing that matters”\textsuperscript{lix} are common. Indeed, one of the authors recently witnessed the production manager of a small manufacturing business throw a freshly delivered 200 page performance report straight into the bin, without even glancing at it. When asked why, the production manager replied - “what use is the report to me? All it contains is last month’s labour absenteeism figures. I need up to date information to manage production, not spurious figures from the accounting department”.

Yet another problem with the performance measures used in many organisations is that they are rarely integrated with one another or aligned to the business processes. Performance measures are also often poorly defined. It is not unusual to observe two people heatedly arguing over some dimension of performance and later find that the root cause of their disagreement was the imprecise definition of a measure.

The response to these criticisms has been a flurry of activity seeking to develop new and better methods of measuring business performance. Some scholars have focused on improving methods of measurement, while others have concentrated on improving the measurement frameworks used and applied. Since the early 1980s, for example, executives have been offered an alphabet soup of concepts and approaches all of which are designed to offer improved methods of measurement (see insert – The Alphabet Soup of Performance Reporting).

<table>
<thead>
<tr>
<th><strong>EBITDA</strong></th>
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<tr>
<td>Earnings before interest, tax, depreciation and amortisation. Arguably, this is a reasonable measure if the company does not happen to have considerable capital expenditure needs and/or a substantial amount of debt to service. The trouble is that today most companies do not fall into one of these categories. The fact is that this measure is widely used by companies as a “smoke and mirrors” mechanism to report rosier projections of its earnings growth potential than is really the case. The most worrying aspect of this is that it is a totally misleading measure of a company's access to further capital injection and its ability to pay interest on its existing debt.</td>
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Invented to overcome national differences in taxation and accounting standards, EBITDA also says nothing about the quality of a company’s earnings. It can be manipulated through aggressive accounting policies relating to revenue and expense recognition plus other such accountancy “shenanigans”. Particularly, it does not take into account a company that depreciates costs over an extended period, when it would have been more realistic – and prudent – to charge them off against revenue. For example, media and cable companies tend to be particular proponents of EBITDA since it makes their income statements look more reassuring than they might otherwise be, yet they have to spend vast amounts of money upgrading their technology assets. So, in effect, this is a ‘suspension of reality’.

<table>
<thead>
<tr>
<th><strong>EVA™ (and its derivatives)</strong></th>
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<tr>
<td>Economic Value Added. Stern Stewart’s method is based not on cash flow, as some people seem to believe, but profit restated (indeed others prefer to call it Economic Profit). It demands a whole set of complex adjustments [non-trained personnel need...</td>
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not apply for the job] - for its sole real virtue, which is making a charge against the restated profits for the weighted average cost of capital. The latter normally turns out at around 10 per cent in today's economic environment.

This adjustment is intended to take some account for the inherent risk of investing money in the firm versus putting the cash into other more risk-averse high interest bearing investments, such as gilts or bonds, called the cost of equity. The purpose of including this hurdle is to ensure that when executives make investment decisions, they make them on the basis that they are not squandering shareholders' funds and a value adding return on investment is obtained. But how this is calculated can be fairly discretionary.

EVA is often also associated with MVA (Market Value Added). MVA is a longer-term measure and its calculation is complex too. Evaluating a company's MVA essentially involves calculating all the money that shareholders could theoretically take out of the business (the current value of its shares and its debts, sometimes called Enterprise Value) and deducting the sum of money that has been put into the company over its lifetime (money raised through share issues, borrowings and retained earnings). If a company has a positive MVA, it has created value; if it has a negative number, value has been destroyed.

**FCF**
Free Cash Flow. Its principal advantage is that it does not require complex and intricate adjustments in order to calculate the appropriate figure. The calculation can be made by picking up any corporation's published statement of accounts and can be done by anyone with the where-with-all of a basic calculator.

It takes operating profit (before taxes and interest), removes the accounting depreciation and amortisation charges plus working capital adjustments to profits [these are not cash sums, and are conveniently identified in most companies' cash flow statements] and then subtracts firstly the amount of tax paid. Next, interest payments and dividends distributed to shareholders - the principal tangible components of the cost of capital - are deducted. Lastly, the amounts of operating capital expenditure expended less the proceeds from any unexceptional asset sales should also be deducted. This is a 'fair and true' way to determine how a company is really performing. However, it does not include the cost of acquiring (or the proceeds of selling) companies, since these are considered as non-recurring transactions.

Arguably it would be better if companies were forced to declare this figure as part of their reporting requirements, but alas it still needs to be calculated in most instances. Companies make much of extolling the virtues of their P&L accounts, which are of course subject to manipulation. From an investor standpoint, the cash flow statement is usually much more interesting and can also be highly revealing.

In addition to these improved methods of measurement can be added the measurement frameworks. Work in this area started with the DuPont pyramid of financial ratios, which was developed in the early 20th century and linked a wide range of financial ratios to return on
investment (see figure 4). The pyramid of financial ratios had an explicit hierarchical structure, linking measures at different organisational levels.

Following their review of the evolution of management accounting systems, Thomas Johnson and Robert Kaplan highlighted the failure of financial performance measures to reflect changes in the competitive circumstances and strategies of modern organisations. These deficiencies indicate shortcomings in the DuPont Pyramid. Its cost focus provides a historical view, giving little indication of future performance and encouraging short termism.

The subsequent revolution in performance measurement prompted organisations to implement measures of non-financial and financial nature that appropriately reflect their objectives. Although General Electric first implemented a balanced set of performance measures in the 1950s, it was the enormous growth in interest in performance measurement in the 1980's and 90's that brought acceptance of the need for organisations to use a balanced set of performance...
measures. This interest led to a plethora of measurement frameworks designed to help organisations implement a balanced set of measures.

Keegan et al. (1989) proposed a performance measurement matrix reflecting the need for balanced measurement\textsuperscript{v}. It categorises measures as being ‘cost’ or ‘non cost’, and ‘external’ or ‘internal’. This reflects the need for greater balance of measures across these dimensions. This is a simple framework and, whilst it does not reflect all of the attributes of measures that are increasingly considered necessary, the matrix should be able to accommodate any measure of performance allowing an organisation to plot its measures and identify where there is a need to adjust measurement focus\textsuperscript{vi}.

The SMART (Strategic Measurement and Reporting Technique) pyramid (see figure 5) developed by Wang Laboratories also supports the need to include internally and externally focused measures of performance\textsuperscript{vii}. It adds the notion of cascading measures down the organisation so that measures at department and work centre level reflect the corporate vision as well as internal and external business unit objectives.

![Figure 5: The SMART Pyramid](image_url)

Following their study of performance measurement in service industries, Fitzgerald et al. (1991) proposed a framework classifying measures into two basic types (see figure 6). Those that relate to
results (competitiveness, financial performance) and those that focus on the determinants of those results (quality, flexibility, resource utilisation and innovation). This reflects the concept of causality, indicating that results obtained are a function of past business performance in relation to specific determinants. This demonstrates the need to identify drivers of performance in order to achieve the desired performance outcomes.

Mark Graham Brown developed the concept of linking measures through cause and effect relationships further. In his Macro Process Model of the Organisation, he shows clear links between five stages in a business process and the measures of their performance. These stages are defined as Inputs, Processing System, Outputs, Outcomes and Goals respectively. The model demonstrates how inputs to the organisation affect the performance of processing systems and ultimately top level objectives of the organisation (see figure 7). Brown argues that each stage is the driver of the performance of the next.

<table>
<thead>
<tr>
<th>Results</th>
<th>Financial performance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Competitiveness</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Determinants</th>
<th>Quality</th>
</tr>
</thead>
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<tr>
<td></td>
<td>Flexibility</td>
</tr>
<tr>
<td></td>
<td>Resource utilisation</td>
</tr>
<tr>
<td></td>
<td>Innovation</td>
</tr>
</tbody>
</table>

Figure 6: The Results and Determinants Framework
The most popular of the performance measurement frameworks has been the Balanced Scorecard proposed by Kaplan and Norton. The balanced scorecard identifies and integrates four different ways of looking at performance (Financial, Customer, Internal Business and Innovation and Learning Perspectives). The authors identify the need to ensure that financial performance, the drivers of it (customer and internal operational performance) and drivers of ongoing improvement and future performance are given equal weighting. The Balanced Scorecard reflects many of the attributes of other measurement frameworks but more explicitly links measurement to the organisation’s strategy than other frameworks. The authors claim that it should be possible to deduce an organisation’s strategy by reviewing the measures on its balanced scorecard.
Kaplan and Norton argue that the full potential of the balanced scorecard will only be realised if an organisation links its measures clearly to the identified drivers of performance. Conceptually, this use of the scorecard is similar to the use of the Tableau de Bord\textsuperscript{li}. Developed in France early in the twentieth century, the Tableau de Bord establishes a hierarchy of interrelated measures, cascading them to different organisational levels, forcing function and divisions of an organisation to position itself in the context of the company's overall strategy.

Despite its widespread use, numerous authors have identified shortcomings of the balanced scorecard. It does not consider a number of features of earlier frameworks that could be used to enhance the framework. The absence of a competitiveness dimension, as included in Fitzgerald's et al.'s results and determinants framework, is noted\textsuperscript{lii}. Others emphasise the importance of measurement of the Human Resources Perspective / Employees Satisfaction, Supplier Performance, Product / Service Quality and Environmental / Community Perspective\textsuperscript{liii}. Failure
of the balanced scorecard to consider these dimensions limit its comprehensiveness as not all measures can be included, as is the case with the Performance Measurement Matrix for example. A further criticism of the balanced scorecard is that it does not reflect different dimensions of performance, as the SMART pyramid and Results and Determinants model do. Neither the customer or internal perspective are defined in terms of the dimensions of performance that determine success, such as the generic strategic objectives of quality, cost, delivery (speed and reliability) and flexibility.

Although not designed as performance measurement frameworks, the European Foundation for Quality Management’s (EFQM) Business Excellence model and its US equivalent the Malcolm Baldridge Quality Award take a broader view of performance, addressing many of the areas of performance not considered by the balanced scorecard. The Business Excellence Model is a broad management model that explicitly highlights the enablers of performance and indicates results areas for measurement. However it is a self-assessment rather than objective measurement framework and the categories for measurement are very broad, limiting the guidance it gives to defining specific areas of measurement.

To reflect the growing importance of satisfying stakeholder requirements, the Performance Prism adopts a stakeholder-centric view of performance measurement. For many organisations shareholders will remain the most important stakeholder. Consideration must be given, however, to other important stakeholder groups such as other investors, customers, employees and suppliers, all of which are incorporated into the balanced scorecard, or variants of it.

In addition to these stakeholders, the Performance Prism also considers a group of stakeholders growing power and significance in the current business environment: regulators and pressure groups. A key consideration for many organisations is the satisfaction of regulatory and legal communities. Regulators of the recently privatised utilities in the UK have significant influence, including the power to impose price restrictions, insist on investment in operations or even revoke an organisation’s licence to operate if performance does not meet its requirements. Regulators are not confined to recently privatised industries, however. There are a variety of regulatory and legislative bodies seeking to prevent organisations from exploiting their competitive position, exploiting their employees or damaging the environment for example. Regulators often provide a voice for stakeholders that do not have a collective voice, whilst pressure groups often express collective opinions and can have a significant influence on the operations of an organisation. Within the Performance Prism regulators and communities consider those stakeholders and the overall impact of the organisation’s operations on society as considered in the EFQM model.
Having identified the key stakeholders of the organisation and defined their requirements, it is necessary to consider whether the organisation has the strategies in place to deliver stakeholder satisfaction. The need to implement measures that reflect and communicate an organisation’s strategies has been a consistent message in much of the recent literature on performance measurement. There is recognition of the need to communicate strategy, check that it is achieved and challenge whether it is correct\textsuperscript{lxvi}.

Roth gathered empirical data showing a correlation between business unit viability, competitive capabilities and business process performance\textsuperscript{lxv}. This demonstrates the need for the third and fourth facets of the Performance Prism: measurement of the processes required to deliver objectives and the capabilities required to support and enhance these processes. None of the existing measurement frameworks addresses and aligns each of these issues.

The fifth and final facet returns to consider stakeholders, which lie at the heart of the Prism. Whilst the first facet is concerned with delivery of stakeholder satisfaction, the final facet reflects the need for organisations to maximise the contribution that stakeholders make to support its operations. For example, satisfaction of customer requirements is a key objective for most businesses, however there is a growing appreciation of the benefits of receiving loyalty and profitability from customers in return.

The five distinct but linked perspectives of performance identified prompt the following questions for organisations to address when defining a set of performance measures:

- **Stakeholder Satisfaction** - who are our key stakeholders and what do they want and need?
- **Strategies** - what strategies do we have to put in place to satisfy the wants and needs of these key stakeholders?
- **Processes** - what critical processes do we need to operate and enhance these processes?
- **Capabilities** - what capabilities do we need to operate and enhance these processes?
- **Stakeholder Contribution** - what contributions do we require from our stakeholders if we are to maintain and develop these capabilities?
In addition to these general business performance frameworks there are also specific frameworks devoted to intangible assets and intellectual capital. In addition to the Skandia Navigator, these include:

**The IC-Index Approach**

The IC-Index Approach represents an attempt to assess an organisation's intellectual capital holistically. According to its developers it can be interpreted as a practice to consolidate all different individual intellectual capital indicators into a single index in order to provide a more comprehensive visualisation of the company's intellectual capital\(^{lxvii}\). Moreover the authors point out that this approach can correlate the changes in intellectual capital with the changes in market values.

The IC-Index Approach is based on an intellectual capital distinction tree, which considers intellectual capital to be composed of human capital and structural capital. The separation between 'thinking' and 'non-thinking' intellectual capital is the criteria for the distinction between the two categories. In fact these categories are considered, respectively, the knowledge embodied in the employees and the overall invisible assets of a company. The former is further split into competence (skills and education), attitude (the behavioural components of employees' work), and intellectual agility (the innovation ability of employees). While the latter is considered as an aggregation of the following three components: the relationship capital or internal structure (the relationships that company undertakes with customers, suppliers, allies, shareholders and other stakeholders), the organisational capital or external structure (all sources of organisational capital e.g. databases, process manuals, culture and management styles), and the renewal and development value (the intangible side of ‘anything’ and ‘everything’ that can generate value in the future - e.g. investments in training employees, reengineering and restructuring efforts, research and development). Figure 10 presents the complete intellectual capital distinction tree.

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**Figure 10: The Intellectual Capital Distinction Tree**

Roos et al. propose consolidating all the different intellectual capital measures into a single index or at least into a small number of indices\(^{lxviii}\). In this way it is possible to provide a comprehensive picture of a company's intellectual capital, which would allow both an inter-company comparison and tracking of the relationship between the intellectual capital and the financial capital of an organisation.
Technology Broker
The Technology Broker model proposed by Annie Brooking helps to calculate a dollar value of intellectual capital\textsuperscript{lxix}. It is based on an interpretation of intellectual capital as an amalgam of four components - market assets, human-centred assets, intellectual property assets and infrastructure assets. Market assets are the market-related intangibles such as brands, contracts, customers, distribution channels, licensing agreements and franchise contracts. Human-centred assets are the knowledge of the people within the organisation and involve components such as expertise, problem solving capability, creativity, entrepreneurial and managerial skills. Intellectual property assets are corporate assets for which it is possible to provide a financial evaluation. Examples of these assets are trade secrets, copyright, patent, service marks and design rights. Finally, infrastructure assets equal those technologies, methodologies and processes that enable the organisation to function.

From an operational point of view the implementation of the Technology Broker starts with a test which is based on twenty questions. These questions are addressed to understand whether the organisation needs to focus on the development of management practices to increase the strength of its intellectual capital. In order to examine the intellectual capital of a company the Technology Broker model uses a number of specific audit questionnaires.

Intangible Asset Monitor
The Intangible Asset Monitor developed by Sveiby is described as “a presentation format that displays a number of relevant indicators in a simple fashion\textsuperscript{lxx}”. It adopts the concept of intangible assets rather than intellectual capital. In particular three categories of intangible assets are taken into account. These categories are the intangibles related to the internal structure, those related to the external structure, and intangibles represented by the competence of people. Internal structure includes intellectual property, patents, copyrights, corporate culture, management processes, networking systems. External structure includes relationships with customers and suppliers. Employee competencies are related to human capital that in turn take into account all the know-how embodied in the individuals working in the firm.

In order to define metrics to assess the intangible assets in each of the above categories the Intangible Asset Monitor identifies three critical measurement areas: growth, efficiency and stability. Under each area the company has to define some key measures to assess its specific intangible assets. Figure11 illustrates the basic structure of the Intangible Asset Monitor. Its main aim is to provide management control. The first step in implementing it is to determine who will be interested in the results. Measurement can be produced for an external or internal presentation. In the former case measures are mainly used to describe the company as accurately as possible in order to communicate the value of the organisation to stakeholders. In the latter case measurement is undertaken for management purposes in order to provide managers with a knowledge information system. The content of the two different presentations (external and internal) is different. Internal management information should be mainly focused on flow, change and control figures, while external measures should be able to communicate key indicators and explanatory text about the organisation’s intangible value.

<table>
<thead>
<tr>
<th>Human Competence</th>
<th>Internal Structure</th>
<th>External Structure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indicators of growth/renewal</td>
<td>Years in profession, Education level, Training costs, Turnover</td>
<td>Investments in internal structure, Customers contributing to systems/process building, Profitability per customer, Organic growth</td>
</tr>
<tr>
<td>Indicators of growth/renewal</td>
<td>Proportion of professionals, Proportion of support</td>
<td>Satisfied customers index</td>
</tr>
</tbody>
</table>
Knowledge Assets Map

The models proposed in the management literature to assess intellectual capital are particularly useful for accounting and for external reporting purposes. However, they do not necessarily provide managers with meaningful tools to assess the company's knowledge assets. The “Knowledge Assets Map” provides managers with a broader framework to evaluate the organisational knowledge from both an external and internal point of view. It is based on a broader interpretation of intellectual capital addressing the assessment of all the knowledge assets of a company. The Knowledge Assets Map provides a framework that helps to promote understanding of the structure of the company's knowledge assets. It allows the identification and definition of the critical knowledge areas of a company and guides the design of indicators to assess the knowledge capital.

The Knowledge Assets Map is based on an interpretation of the company's knowledge assets as the sum of two organisational resources: Stakeholder Resources and Structural Resources. This distinction reflects the two main components of an enterprise, its actors, who can be either internal or external to the organisation, and its constituent parts - the elements at the basis of the organisation's processes. Figure 12 illustrates the hierarchy of knowledge assets with its sub-classifications. Stakeholder Resources are divided into Stakeholder Relationships and Human Resources. The first category identifies all external actors of a company while the second represents the internal actors. Structural Resources are split into Physical and Virtual Infrastructure, which refers to their tangible and intangible nature respectively. Finally, the Virtual Infrastructure is further sub-divided into Culture, Routines & Practices and Intellectual Property.
Figure 12: Knowledge Assets Map

The six categories of knowledge assets identified by the Knowledge Assets Map are defined in further detail below.

- **Stakeholder relations** include all forms of relationships established by the company with its stakeholders. These relationships could be licensing agreements, partnering agreements, financial relations, contracts and arrangements about distribution channels. The stakeholder relationships include also customer loyalty, company names and brand image, which represents a fundamental link between the company and its stakeholders.

- **Human resources** contain knowledge provided by employees in forms of competence, commitment, motivation and loyalty as well as in the form of advice or tips. Some of the key components are know-how, technical expertise, and problem solving capability, creativity, education, attitude, and entrepreneurial spirit.

- **Physical infrastructure** comprises all infrastructure assets, such as structural layout and information and communication technology like computers, servers and physical networks.

- **Culture** embraces corporate culture and management philosophies. Some important components are the organisation’s values, the networking practices of employees as well as the set of mission goals. Culture is of fundamental importance for organisational effectiveness and efficiency since it provides the organisation’s members with a framework in which to interpret events. The culture provides organisations with a framework that encourages individuals to operate both as an autonomous entity and as a team in order to achieve the company’s objectives.

- **Practices & Routines** include internal practices, virtual networks and routines, i.e. tacit rules and procedures. Some key components are process manuals providing codified...
procedures and rules, databases, tacit rules of behaviour as well as management style. Practices and routines determine how processes are being handled and how workflow processes flow through the organisation.

- Intellectual property is the sum of patents, copyrights, trademarks, brands, registered design, trade secrets and processes whose ownership is granted to the company by law. It represents the tools and enablers that allow the company to perform its daily processes to produce results.

The message underpinning all of these methodologies and frameworks is a desire to get a better handle on how well organisations are performing (in the short) and how well they are likely to continue to perform (in the long term). Within all of these frameworks and as an integral part of all of these efforts is the desire not only to understand how well the organisation is performing, but also what is driving that performance. A common theme appears to be that performance is driven by a whole host of factors, a fundamental one of which is the organisation's intangible assets which are embedded in its processes and capabilities. Clearly a fundamental dimension underpinning these processes and capabilities - indeed an integral part of many of them - is the whole issue of management and leadership. Without management and leadership, organisations would not exist. They would not be able to deliver value to stakeholders. There would be no requirement for organisations to operate, etc. So clearly an important area to focus on is management and leadership and the measurement of this and it is to this topic that this paper will now turn its attention.

**Reporting Management and Leadership:**

We have argued that more formal reporting in the field of management and leadership is not only desirable, but also inevitable, but what format will this reporting take? What measures of management and leadership are available? And how will these measures be best applied? The natural response to questions such as these is to launch into a discussion of appropriate methods of measuring management and leadership. Frameworks such as the ones discussed previously and the one developed by the Institute of Employment Studies for CEME's National Measurement Initiative provide some guidance on this topic. The Institute of Employment Studies framework, for example, suggests that at a national level appropriate measures of management and leadership would cover:

- **Management numbers** - stock of UK managers, recruitment and wastage data.
- **Development of management capability** - education and qualification levels, ongoing training and development.
- **Management capability** - proportion of managers fully proficient, skills missing amongst managers, employees' views of management capability.
- **Management practice** - higher levels of work practices (use of appraisal systems, quality reviews, employee involvement, etc).
- **Outcomes and benefits** - organisational activity (innovation), organisational outcome (employee satisfaction, management satisfaction, customer satisfaction, productivity, business survival) and individual outcome (comparative salaries, comparative unemployment).
In fact the Institute of Employment Studies report identifies over 50 different measures that could be used to track management and leadership at a national level. And this is the problem that results when we start with the question “what should we measure?”. We simply end up identifying long lists of measures. The danger with this approach is that there are numerous dimensions of performance that might be interesting and/or relevant to track. In the author’s view a better approach is to take a step back and ask - “what do we want to know”. The distinction is subtle, but important. Far too often people see measurement as a means of reporting. Instead it is far more powerful to see measurement as a means of providing insight. In the field of corporate reporting what analysts, and other external stakeholders, want is insight into what is happening inside organisations today and what is likely to happen tomorrow.

If we take the question of corporate reporting in the field of management and leadership from this perspective then we end up not worrying about specific measures. Instead we are led into a discussion about what insights analysts and other external stakeholders want into organisational performance from the perspective of management and leadership. The way to do this is to explore what are the questions that people both within and without the organisation would want to ask about the organisation’s managers and leaders.

To take this further we have to explore what are the roles of managers and leaders in organisations. The position taken by CEML is that management and leadership are different but inter-linked. Leadership is about creating strategic and local vision, and engaging people in the pursuit of these, management involves the planning for and controlled use of resources in pursuit of these visions. In light of this then it is necessary to separate the insights that are required into two distinct components, a strategic component, concerned with leadership and an operational component, concerned with management. Clearly these two components are highly inter-related, but for the sake of simplicity they are discussed separately.

**The Strategic Component:**
An organisation’s leadership capability is intricately associated with its ability to create strategic and local vision and engage people in the pursuit of this. Hence relevant measures will allow those associated with the organisation to address the following questions:

- How clearly are the organisation’s vision and strategy articulated?
- How widely are the vision and strategy understood, both by those within and without the organisation?
- To what extent do people within and without the organisation believe in the organisation’s vision and strategy?
- To what extent are people within the organisation engaged in the pursuit of the organisation’s vision and strategy?

**The Operational Component:**
Once the vision and strategy have been developed and deployed they have to be enacted. Now the questions that have to be addressed centre on issues, such as:

- Given the requirements of the strategic plan what are the implications for management and leadership capability and competencies?
• How does this compare with an objective assessment of where we are now? How do we close the gap?

• How can we best communicate to investors to show the value that we derive from our management and leadership capability?

• How can potential managers and leaders more readily understand the organisation’s competitive advantage so as to create a “waiting list of people to join?”

• How can we best demonstrate to the board or governing body that there is an appropriate focus on human capital - e.g. management development, selection planning, proper selection processes?

**Balancing the Long and Short Term:**

Clearly the answers to these questions will influence the development of management and leadership capabilities in the organisation in both the long and short term. Hence the final set of questions that have to be addressed centre around issues such as:

• What is the current status of our management and leadership capability?

• What is the likely future status of our management and leadership capability?

• Are the arrangements we have in place for developing our management and leadership capability appropriate?

• Are the arrangements we have in place for developing our management and leadership capability working?

• Do those who are investing in our organisation understand our management and leadership capability?

• Do those who are thinking of joining our organisation understand our management and leadership capability?

Taken together these fifteen questions provide an initial framework of themes and issues that the authors believe organisations should be encouraged and/or required to address through fact-based evidence in their annual reports. If this approach were adopted then it would be possible for analysts and other stakeholders to assess whether or not they were confident that the managers and leaders in the organisation under scrutiny were:

• Developing, communicating and delivering their chosen strategy.

• Utilising the resources and talents within the organisation appropriately.

• Confirm that investments are being made today that will ensure the organisation retains an appropriate pool of management and leadership talent tomorrow.

The appendix at the end of this document suggests some potential measures that might be used to answer these fifteen questions, although this list is by no means exhaustive.

**Recommendations and Further Work:**
Clearly this approach and framework of questions requires further exploration and discussion. We would therefore recommend that:

- Potential users of this approach are consulted with a view to testing the feasibility of the approach and enhancing the framework of questions proposed.

- Potential recipients of the information – analysts and other stakeholders – are consulted with a view to testing their receptiveness to the approach and establishing how they would like to see the proposed framework of questions enhanced.

- Once these two periods of consultation have been completed then we would suggest that a series of pilot reports are produced in collaboration with a variety of organisations from both the public and private sectors.
Appendix: Measures for Answering Questions on Management and Leadership

It has been argued that no single set of measures is going to fit all organisational situations. The approach taken is therefore one of offering a range of measures from which organisations can select a key set appropriate to their needs and situations (see table 2). These measures have been gathered together in the form of a “toolkit”, which allows them to be described in a consistent format. Each measure in the toolkit that follows is described under the following four headings:

A. The Rationale
B. How Do We Measure
C. Where appropriate, a pro-forma in which you can enter relevant data that you have or can collect, and a guide that takes you through the steps to derive a key indicator or indicators from this.
D. Comments on interpretative points to be made in presenting the output.

Table 2: The Potential Measures

<table>
<thead>
<tr>
<th>A</th>
<th>MORALE</th>
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<tbody>
<tr>
<td>1</td>
<td>Absenteeism - across all levels</td>
</tr>
<tr>
<td>2</td>
<td>Accidents - across all levels</td>
</tr>
<tr>
<td>3</td>
<td>Employee turnover</td>
</tr>
<tr>
<td>4</td>
<td>Director and manager turnover</td>
</tr>
<tr>
<td>5</td>
<td>Employee satisfaction (Staff survey measure)</td>
</tr>
<tr>
<td>6</td>
<td>Sickness - across all levels</td>
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</tbody>
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<thead>
<tr>
<th>B</th>
<th>MOTIVATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Appraisal - completion rates</td>
</tr>
<tr>
<td>2</td>
<td>Percent of jobholders for whom documented annual appraisal has been agreed</td>
</tr>
<tr>
<td>3</td>
<td>Percent of jobs for which objectives have been documented</td>
</tr>
<tr>
<td>4</td>
<td>Percent of jobs for which job descriptions exist</td>
</tr>
<tr>
<td>5</td>
<td>Employee understanding of strategy (Staff survey measure)</td>
</tr>
<tr>
<td>6</td>
<td>Employee understanding of vision (Staff survey measure)</td>
</tr>
<tr>
<td>7</td>
<td>Employee retention</td>
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<tr>
<td>8</td>
<td>Director and manager retention</td>
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<tr>
<td>9</td>
<td>Working hours</td>
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<table>
<thead>
<tr>
<th>C</th>
<th>INVESTMENT</th>
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<tbody>
<tr>
<td>1</td>
<td>Benchmarked remuneration levels (External benchmarks)</td>
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<td>2</td>
<td>Director and manager salaries as % of total salaries</td>
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<tr>
<td>3</td>
<td>Human resource spend per employee</td>
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<tr>
<td>4</td>
<td>Training investment</td>
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<th>D</th>
<th>LONG TERM DEVELOPMENT</th>
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<tbody>
<tr>
<td>1</td>
<td>Current management and leadership capability</td>
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<td>2</td>
<td>Potential management and leadership capability</td>
</tr>
<tr>
<td>3</td>
<td>Management and leadership skills gaps</td>
</tr>
<tr>
<td>4</td>
<td>Percent of jobs within level of which emergency cover identified</td>
</tr>
<tr>
<td>5</td>
<td>Percent of jobs within level for which long term cover identified</td>
</tr>
<tr>
<td>6</td>
<td>Percent of jobholders for whom a development plan has been agreed</td>
</tr>
<tr>
<td>7</td>
<td>Percent of jobs for which competencies have been audited</td>
</tr>
</tbody>
</table>
A. Morale

Why should we measure it?
Leaders and managers have a role to play in developing and maintaining employees’ morale. Several research studies have shown the importance of maintaining employees’ morale and therefore increase the satisfaction of employees with their job. The studies highlight the contribution that increasing employee satisfaction can make to increasing customer satisfaction and financial performance.

These pieces of research indicate the effect on the organisation’s performance of increased employee satisfaction. In addition employee satisfaction is necessary to maintain a loyal workforce increasing employee retention, which in turn reduces the cost of recruitment. Therefore leaders and managers should study the measures in this index and understand their role in helping to improve upon these measures.

The measures offered in this index are considered as indicators to the level of morale of employees and their overall satisfaction with the organisation. The level of morale is an important input into the capacity planning process, providing an indicator of the likely availability of employees and skills when required. As a result data from this measure is an important input to planning and scheduling of all operations and activities.

The number of safety incidents at work is an indication of the employees’ working environment. Higher than industry average number of safety incidents will have an adverse affect on employee satisfaction and discourage employees from joining or staying with the organisation.

Clearly the rate at which people leave provides an indication of the level of employee satisfaction with the organisation, as dissatisfied employees are more likely to leave the organisation.

How do we measure it?
(Instructions for use, the input data/evidence required and the calculation to be carried out)

1. Absenteeism
This measures the proportion of time that employees are present and available for work. The data required to calculate this measure should be available from the personnel department who should maintain records of absence and its cause. To use absenteeism in this way, the level should be compared to a benchmark level for the region or industry.

2. Accidents
The number of accidents assesses the number of incidents that occur within the organisation which risk the safety of its employees in some way. Safety incidents - are incidents where safety policies / codes of practice are breached, they include incidents where injury or ill health is caused by a “safety” incident at work.

3. Employee Turnover
This measures the rate at which employees leave the organisation. The time period for this measure will be determined by the frequency with which people join and leave the organisation. Where people join and leave the organisation frequently (i.e. where turnover is high) it is important to calculate and analyse this measure frequently in order to identify trends in performance and causes of fluctuations. The Employee Turnover measure should include analysis and comparison by skill type.

Analysis of the reasons for leaving is also important. A “leavers interview” for all employees leaving the organisation should be used to identify the many reasons employees decide to leave and assess overall levels of satisfaction. If common and recurring reasons for leaving are reported, operational measures should be implemented to track whether specific action can reduce employee turnover. One example would be “Average increase in salary on leaving”, which should be analysed by job or skill type.

The benchmark level of employee turnover will vary between industries and skill types. For example, the benchmark for call centres, where skill levels are not high and substitute labour is readily available, is in the region of 40%.

4. Director and Manager Turnover
The time period for this measure will be determined by the frequency with which executives join and leave the organisation. Where executives join and leave the organisation frequently (i.e. where turnover is high) it is important to calculate and analyse this measure frequently in order to identify trends in performance and causes of fluctuations.

The benchmark level of executive turnover will vary between industries and skill types. Outside benchmark values can be obtained from a variety of sources.

5. Employee Satisfaction
The only real way of measuring employee satisfaction is to ask the employees through an employee satisfaction survey. Employee satisfaction surveys often provide a numerical value for the level of employee satisfaction, a percentage for example. Where multiple surveys are carried out over a period of time, such index numbers indicate trends in satisfaction and allow correlations to be identified to assess the drivers and consequences of employee satisfaction.

6. Sickness
As with absenteeism, sickness measures the proportion of time that employees are present and available for work. The data required to calculate this measure should be available from the personnel department who should maintain records of where absence is caused by sickness.

Measurement interpretation
(The output statement and comments on interpretative points)

Use of the index should include an analysis of each measure based on a number of criteria. Such criteria include job types and departments to identify where morale is lowest or accidents and illness are most common.

Analysis should also consider the causes of low morale, determining the severity of the cause to assess how willing employees are to attend work if they have illness or injuries that are considered to be relatively minor, and whether the cause is an occupational illness or injury.

Analysis should be made of the root causes of all incidents, accidents and fatalities, so that action can be taken to eliminate that cause and ensure that the incidents do not reoccur.
Turnover has considerable implications for the management of human resources and the availability of skills and competencies necessary to undertake the operations of the organisation. Trends of particular skills leaving the organisation are important when planning recruitment and training policies as well as policies for staff retention.

If employee turnover is high, the cost of recruitment, training and employee development will increase. As a result, this measure is most important in the area of an organisation where the level of skill or competence is highest. Especially where these skills and competencies provide a competitive advantage to the organisation and they are costly to replace. Where individual executives have important knowledge expertise or skills, consideration should be given to the impact of losing those skills, especially if they are lost to a competitor. As a result some organisations have classified their executives according to their value to the organisation. High valued executives are offered significant incentives to encourage them to stay.

It is worth noting that turnover can also be too low. New recruits bring new ideas to organisations. Hence there is a need to ensure that new people constantly join organisations. This may require existing employees to make way for such new recruits.

Great value in assessing employee satisfaction is derived from the identification of the drivers of satisfaction. Where possible, the drivers of employee satisfaction that employees consider most important, should be converted into operational measures within the organisation. Such drivers might include salary or benefit benchmarks, spend on training, working hours, working practices, health and safety considerations, etc.

Perceptions of performance are more important than actual performance in relation to employee satisfaction. For example, even though pay levels might be higher than that in other organisations, if the employees don’t realise that this is the case employee satisfaction will not be improved. It is important therefore to consider and manage employees’ perceptions when attempting to improve employee satisfaction.

B. Motivation

Why should we measure it?
A committed and motivated work force is critical to maximising an organisation’s potential achievements and therefore leaders and managers have a significant responsibility for gaining that commitment. Highly motivated employees will seek to work beyond the bounds of their specific job role in order to improve the operations of the function, process or organisation. Highly motivated employees will seek to excel in their job, with career progression an objective along with organisational performance improvement. Although the workforce may have all of the skills required and might have very low absenteeism, the contribution they make to the organisation will only be maximised if their commitment and motivation is high.

Employee motivation and commitment is one of the major contributions that employees can make to the organisation as it ensures that they are employing maximum effort to their activities and working to the benefit of the organisation. This measure also indirectly assesses employee satisfaction levels, as employees will not be motivated or committed unless they are satisfied. In turn the level of commitment to the organisation should positively correlate with the levels of retention of employees throughout the organisation.
By its nature the measurement of employee commitment and motivation has to be based on qualitative assessment. Organisational commitment can be assessed by using employee surveys or appraisals to establish how well aligned individual objectives are to organisational objectives. This is linked to the measure of goal congruence. This assessment should result in a ranking of alignment, which can be collated for all employees.

Awareness of and congruence with the organisation's mission or vision is an important measure of commitment within the organisation. Part of the role of leaders and managers should be concerned with the promotion and communication of the mission and vision throughout the organisation. Use of this measure is important for the alignment of strategies within the organisation and ensuring that all employees have the same understanding of the organisation's objectives and act accordingly. This is important if the organisation's strategy is to be effectively executed to gain employee commitment.

The length of working hours is a basic feature of an employee's terms and conditions of employment and has a significant effect on employee satisfaction. Long working hours are likely to have a negative effect on employee satisfaction and will therefore adversely affect motivation.

**How do we measure it?**
(Instructions for use, the input data/evidence required and the calculation to be carried out)

1. **Appraisal completion rates**
   This measure demonstrates how well managers are managing staff by ensuring that all personal appraisals are completed. Personal appraisals show employees that their contribution is valued and that their future development is of importance to the organisation.

   The HR function should keep a record of who is due an appraisal and should chase and track when those appraisals are complete. In many organisations performance appraisals are directly linked to a performance bonus and therefore the completion becomes even more crucial.

2. **Percent of job holders for which a documented annual appraisal has been agreed**
   This measure is linked to the that of appraisal completion rates. It is essential that not only is an appraisal completed for an individual but that the appraisal is documented for future reference. The motivation of employees will increase if they feel that their performance is being monitored and rewarded.

   The extent to which appraisals are implemented throughout the organisation is a consideration for each individual business. Where all employees are treated equally the motivation of the whole workforce is increased. Only giving a proportion of the workforce an appraisal will be divisive.

3. **Objectives per job role**
   Performance appraisals can only really be implemented where performance objectives have been set for each individual. To ensure fairness across roles standard objective frameworks should be completed for each role in the organisation.

   As for appraisals it is motivational for staff if all roles are treated consistently. The role of the HR function should be to create these objective frameworks and monitor their use across the organisation.

4. **Percentage of jobs for which job descriptions exist**
In addition to job objectives, it is worth setting out job descriptions that detail the tasks and activities individuals are expected to undertake on an ongoing basis. Often these are structured around short, medium and long term tasks, with a separate section for ad hoc items. Job descriptions are valuable because they clarify for individual employees what is expected and needed of them.

5 & 6. Employee understanding of strategy and vision
The mission and vision of the organisation is a general statement which identifies the basic purpose and overall objectives of the organisation. Generally speaking strategies and objectives throughout the organisation should be aligned to this statement and therefore this measure can be used to check on whether employees understand the organisation's mission, strategies and objectives and whether the actions they take are consistent with the organisation's mission, strategies and objectives. Congruence is the measure of the extent to which all employees understand and accept the organisation's mission, strategies and objectives.

Data for this measure can be collected through the employee satisfaction survey. This can be achieved by assessing the level of agreement with a series of statements, which relate to the organisation's mission, strategies and objectives.

7. Employee retention
This measure reports on the number of employees who remain with the organisation over a period of time. The time period for this measure will be determined by the age of the company and trends of employee migration within the particular industry.

Analysis of the reasons employees remain with the organisation is important. An employee survey could be used to identify the many reasons employees decide to stay and assess overall levels of satisfaction. If common and recurring reasons for staying are reported, operational measures should be implemented to track whether specific action can increase employee retention.

8. Director and manager retention
This measure reports on the number of directors or managers who voluntarily remain with the organisation over a period of time.

An analysis of the reason directors or managers remain with the organisation is important. A number of techniques such as surveys, appraisals or focus groups can gather data as to why senior level staff are retained.

9. Working hours
Working hours are those hours actually worked by employees of the organisation as part of their terms and conditions, with the addition of overtime. The measure should consider actual hours worked rather than those charged or recorded.

It is important to compare the level of working hours with those of competitors and other companies in comparable industries. This can be done through benchmarking activities.

This measure should be analysed by job type as there may be significant differences between managerial and subordinate positions. The data for this measure should be available from the "manage human resources process" which is responsible for recording work undertaken.

Measurement interpretation
(The output statement and comments on interpretative points)
In addition to direct measurement of motivation and commitment through appraisals and surveys it should be possible for the organisation to define surrogate measures of motivation and commitment. The survey and appraisal approaches should be used to identify the drivers of motivation and commitment within the workforce. Once identified operational measures should be established for each of these drivers.

The measure of employee feedback / suggestions is an example of a quantifiable measure that provides an indication of motivation and commitment of employees as they seek to stimulate improvement of the organisation’s performance.

Please note however that the qualitative and perception based nature of the measure will affect its consistency, accuracy and precision.

To assess the alignment of actions there is a need to make a subjective assessment during the personal appraisal process. As part of the process the assessment should be quantified and collated to give an indication of congruence to goals across the organisation. There is a need to provide those undertaking appraisal with guidance to improve consistency of this subjective assessment.

When measuring working hours, it is important to do so in the context of the terms and conditions offered by competitors or other organisations to which employees could move. Employees' perceptions of the terms and conditions available elsewhere will affect their satisfaction, so comparable terms and conditions must be maintained. Although working hours might be longer than in other organisations this might be compensated for by other benefits, such as pay.

The employee satisfaction survey / analysis of reasons for employees leaving should include analysis of the significance of long working hours. Use of this measure is important where long working hours are identified as causing dissatisfaction and employee turnover.

C. Investment

Why should we measure it?

Levels of remuneration are an important contributor to employee satisfaction. Satisfaction will be adversely affected if salary levels are less favourable than those offered by competitors or geographic norms. Leaders and managers of organisations therefore need to consider and balance employee remuneration with other organisational benefits and the levels of employee commitment this engenders.

The investment in the HR function indicates the commitment of the organisation to employee satisfaction. The level of communication with employees, the level of training and staff development, are activities that are co-ordinated by the HR department, and as such will affect morale and motivation. Leaders of organisations need to consider the investment in this area of their organisation and the benefits this will deliver in terms of employee satisfaction and retention.

The level of an organisation’s investment in training and staff development is an important indicator of the organisation’s commitment to employee development and skills enhancement, which will indirectly contribute to employee satisfaction. Analysis of an organisation’s investment in training is important in identifying where training is focused in comparison to skills requirements in order to deliver competitive advantage.
How do we measure it?
(Instructions for use, the input data/evidence required and the calculation to be carried out)

1. Benchmarked remuneration levels
The comparison for benchmarking of this measure should be as appropriate as possible for the business and job in question, given the market for the skills in question.

Comparison vs. competitors is most appropriate when skills and competencies held provide competitive advantage and competitors are likely to require similar skills.

Comparison with industry standards are appropriate when many businesses in the industry require similar skills sets and hence are trying to recruit the same potential employees.

Comparison with geographical standards or norms is more appropriate where the skills required are in abundance in a given area.

The personnel department (plan and manage enterprise - human resources process) will keep records of the salaries and benefits that are given to employees. It will also be their responsibility to undertake benchmarking activity to understand details of comparable geographical and industry norms. Furthermore feedback from current employees and applicants for new jobs will provide indicators of current norms.

2. Director and manager salaries as a % of total salaries
This measure is an important one, but should not be viewed in isolation as it can be read in a number of ways. The % of director and manager salaries might be high, for example, because the organisation is top heavy and contains too many managers and/or directors. Similarly it might be too high because the salaries paid to directors and managers are out of proportion to those paid to the rest of the workforce.

3. Human resource spending per employee
The financial accounting information system of an organisation should maintain data regarding the staff costs incurred in the HR department while the organisation’s personnel records will identify the number of employees in the department.

Comparison of the investment in the HR department with other organisations should take into account the way in which the HR process is undertaken differently in different organisations (e.g. the level of centralisation).

4. Training investment
Training and staff development is any activity provided or funded by the organisation to enhance an employees skills or capabilities. Training includes internal and external training courses and “on the job” training, although in the case of “on the job” training it may be more difficult to identify specific “offers” of training and the training is less likely to be voluntary.

Spend on training includes training that is bought from outside suppliers and training that is provided in-house. For in-house training and development it may be necessary to attribute a notional cost. There is also a need to consider the value of “on the job” training.

The desired level of expenditure per employee will vary between organisations. Spend is likely to be higher in organisations requiring higher skill levels to be competitive, or where benefits
such as training and personal development are important to maintain a satisfied and committed workforce.

**Measurement interpretation**  
(The output statement and comments on interpretative points)

The competitiveness of salaries has considerable implications for the retention of employees and the ability to attract new employees and hence ensuring the availability of the necessary skills and capabilities. The use of company-wide average salaries produce little valuable data. An analysis by job or skill type is essential to provide meaningful comparison.

However, please note that it is also possible that dissatisfied, demotivated or uncommitted employees could be tempted to stay with the organisation by salaries above industry or geographic norms. Leaders of an organisation should therefore create processes that address the issues of demotivation and identify employees who are not committed.

The actual spend on Human Resources will vary considerably depending on the way HR is executed and the nature of the activities undertaken. In many organisations HR activities are centralised and the HR department is entirely responsible for all recruitment, staff development and training, industrial relations, etc. In other organisations many of these activities are delegated to line managers to whom the central HR department offer support.

Some national governments and industrial associations provide training grants to organisations, in which case this measure becomes important for the purposes of claiming the grant offered. Those organisations participating in national employee development schemes, such as Investors In People in the UK, will find this measure to be essential rather than optional.

### D. Long Term Development

**Why should we measure it?**

It is essential that labour and key skills are available when required in order to satisfy demand. This index assesses how well human resources are planned and developed in order to ensure that the organisation has the right skills and that the skills and labour are in the right place at the right time to satisfy demand for the organisation’s products and services. Such planning of human resources should be included in the capacity planning process when scheduling activities. Hence this is an important measure of the effectiveness of the planning processes.

Skills requirements need to be identified as part of the strategy formulation and implementation process. Skills requirements for specific processes or functions need to be identified to show which people have which skills and what level of competence they have reached at that skill. A skills audit can be used to identify the skills that are available throughout the organisation. Such an analysis can demonstrate where skills gaps need to be closed.

This index can be used to determine whether the organisation has sufficient flexibility to cope with changes in demand or absence of employees with key skills. It is important that an organisation has sufficient coverage of important skills, such as those of bottleneck operations or those which provide competitive advantage. It is important that these skills are always available when required.
This index demonstrates how the leaders of an organisation can anticipate demand for specific skills and to fulfil that demand in order to ensure that the performance of the organisation is not impacted in any way.

**How do we measure it?**
(Instructions for use, the input data/ evidence required and the calculation to be carried out)

1. **Current management and leadership capability**
   Appropriate psychometric tests should be used to analyse the current management and leadership capability to cope with the future demands of the business.

   An audit of current management skills can be carried out by looking at past appraisals and the performance of those manages within their own functions.

2. **Potential management and leadership capability**
   In order to predict the potential of current employees in terms of management and leadership capability an organisation needs to firstly understand the psychometric profile of their current successful leaders and managers. A number of commercially available psychometric tests can be used for this purpose. In addition competency based interviews can be employed to determine those competencies that are deemed important by the organisation.

   Once the profile and competencies have been determined the organisation should test and interview those employees who have been identified as having management and leadership potential.

   Finally a succession plan needs to be developed and personal development plans created for those with the appropriate profile and competencies identified above.

3. **Management and leadership skills gaps**
   This is a key measure of the availability of the appropriate skills required to achieve organisational objectives and execute business processes effectively. Having the appropriate mix of skills can be a significant source of competitive advantage.

   This measure compares the skills available within the organisation in comparison to the skills required. As a result it measures how well the human resource management process or function identifies and fills gaps in the skills currently available within the organisation. This includes the co-ordination and planning of recruitment and training to satisfy organisational requirements.

   This measure also evaluates the contribution employees make in terms of the skills they have to offer. Use of this measure, and the psychometric tests discussed above, should be related to the measures of skills coverage which assesses the number of people who have management and leadership skills.

4. **Percent of jobs within level of which emergency cover identified**
   It is most important to use this measure in relation to key skills, such as “shortage” skills, where their absence can constrain the activities of the organisation, or skills which provide competitive advantage, the absence of which could affect the competitiveness of the firm.

   Skills availability will be affected by the size of the workforce/ skills base and the speed with which the labour/ skills can be deployed to the point at which they are required. In order to maximise availability of labour and skills it is possible to maintain a large workforce, however
this can lead to inefficiency and under-utilised skills. Therefore it is important to consider headcount, labour cost and utilisation measures in conjunction with this measure.

It is most important to use this measure in relation to key skills, such as “shortage” skills, where the absence of the skill can constrain activities of the organisation, or skills which provide competitive advantage, the absence of which could affect the competitiveness of the firm.

There is a need for a feedback mechanism to determine when skills and labour are not available and to analyse the causes so that they can be reduced. This mechanism should include feedback from operational areas to the planning human resource process.

5. **Percent of jobs within level for which long-term cover identified**

This measure is closely related to that of multi-skilling. Skills coverage focuses on the organisational level, measuring whether there are sufficient skills within the organisation. Multi-skilling focuses on the individual, assessing how many different skills individuals within the organisation have.

Use of this measure should be focused on specific, key skills that are important to the organisation. Using the measure as a global indicator across the organisation can also provide an indication of the overall flexibility of the organisation.

Data for such a measure should be kept as part of the training plan for the management of the human resources. In addition such information is often maintained at the point at which skills are used, such as the shop floor. This should be linked to the skills inventory, which monitors employees' competence at specific skills.

Where there is an identified paucity of skills longer term training and development plans should be devised to preempt the potential gap in skills coverage.

6. **Percent of jobholders for whom a development plan has been agreed**

This measure demonstrates how well managers are managing staff by ensuring that all development plans are completed. Personal development plans demonstrate to employees that their future development is of importance to the organisation. In addition the fact that a company is willing to invest in an individual can greatly increase the motivation and job satisfaction.

The HR function should keep a record of who has a personal development plan and should chase and track when those plans are complete. It is essential that not only is a personal development plan completed for an individual but that the development plan is documented for future reference. The motivation of employees will increase if they feel that their personal development is being monitored and encouraged.

The extent to which development plans are implemented throughout the organisation is a consideration for each individual business. Where all employees are treated equally the motivation of the whole workforce is increased. Only giving a proportion of the workforce a development plan will be divisive.

7. **Percent of jobs for which competencies have been audited**

Personal development plans can only really be implemented where the competencies for that role have been identified. To ensure consistency across the organisation all roles should be analysed and a set of competencies and related training courses should be created.
The role of the HR function (or separate training function in some cases) should create the initial competency frameworks and then audit their relevance after a set period of time.

8. Training days
Training and staff development days should measure any activity provided or funded by the organisation to enhance an employee's skills or capabilities. Training includes internal and external training courses and "on the job" training, although in the case of "on the job" training it may be more difficult to identify days of training.

Measurement interpretation
(The output statement and comments on interpretative points)

It is possible to increase skills coverage by increasing headcount so that there is surplus labour to cover unexpected eventualities. Although it might be necessary to maintain surplus key strategically important skills, this will usually result in inefficient use of the workforce. As a result, when using this index, it is important to also consider the measures of headcount and labour / skills utilisation.

It is important that causal analysis of this measure is undertaken. Such analysis will allow the identification of the reasons for skills / labour being unavailable and hence action can be taken to prevent it recurring. This might include recruitment, training or improved planning and scheduling of activities.

Analysis should also include split by job type and department to analyse where the planning is most effective and where improvement is required.

An effective inventory of the skills should be based on the strategic requirements of the organisation. As a result an appropriate strategy, and qualitative assessment of skills requirements to execute it, are essential if this measure is to be effective.

As well as company-wide analysis of training provided per employee, further analysis by job grade or type allows greater understanding of the areas of the business in which training is being focused in comparison to areas where there are skills shortages or requirements. The desired level of training investment per employee will vary between organisations. Training provision is likely to be higher in organisations requiring higher skill levels to be competitive, or where benefits such as training and personal development are important to maintain a satisfied and committed workforce.

E. External Perception

Why should we measure it?
Measurement of the number of people that apply for each job that is advertised assesses the number of people who want to work for the organisation. The measure of job acceptances is related to the measurement of employee satisfaction as it assesses whether people want to work for the organisation. These measures provide an indication of the perceived attractiveness to potential employees, of the organisation as an employer. This provides an indication of the perception of the organisation by people outside it. These perceptions will be influenced by numerous factors including, existing employee word of mouth.

This index also assesses how well the recruitment process advertises vacancies, including targeting advertising to people who are likely to apply.
How do we measure it?
(Instructions for use, the input data/evidence required and the calculation to be carried out)

1. Job applications: vacancies
Applications are requests by potential employees to join the organisation. In the case of this measure applications are responses to adverts for specific jobs rather than speculative applications.

Vacancies are posts within the organisation which are currently unoccupied by an employee. In this case they are the subject of adverts to recruit people.

Analysis of the measure should include by job or skill type as this will indicate the appeal of the company in different employment markets.

The data required to calculate this measure should be readily available within the HR function from those who receive and record all applications for each job advertised.

It is also worth tracking the number of unsolicited applications, as this provides an indication of people's perception of whether or not the organisation is a desirable place to work.

2. Job offers: job acceptances
Job offer is the offer of employment from the organisation to an individual. A job acceptance is a job offer to an individual who subsequently decides to join the organisation.

The time period for this measure will be dependant on the volume of job offers made. The higher the volume, the more frequently the measure should be used and analysed, so that trends in rejected offers can be identified promptly and appropriate action can be taken.

The personnel department (plan and manage enterprise - human resources process) should monitor all stages of the recruitment process including the number of offers made and those rejected. In calculating and reporting this measure, this process or department should undertake analysis of the reasons that offers have been rejected so that any necessary action can be taken to reduce them.

Measurement interpretation
(The output statement and comments on interpretative points)

This index provides a measure of the external perception of the organisation since it indicates the number of people who are attracted to the organisation as an employer.

This index has implications for the ability of the organisation to recruit people with the skills and competencies it requires to compete.

It is important for the organisation to analyse offers rejected by the job type or skills of the job offer. The more costly or difficult to acquire the skill, the more important that the appropriate applicants agree to join the organisation.

In addition, if it is possible to identify the reason for the applicant rejecting the offer, this would provide useful information when reviewing recruitment policies and will indicate external perceptions of the organisation.


Anon (2000) “Measures that Matter: An Outside-in Perspective on Shareholder Recognition”, Ernst and Young, UK Study.

Conducted by PricewaterhouseCoopers in 1997-98.


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